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**CONNECTING THE DOTS: A HISTORICAL AND POLITICAL ANALYSIS OF
ECONOMIC REFORM AND ITS RELATIONSHIP TO FOREIGN INVESTMENT
AND BUSINESS IN KAZAKHSTAN AND UZBEKISTAN.**

By

Pamela E. Blackmon

A DISSERTATION

Submitted to the Faculty
of the University of Miami
in partial fulfillment of the requirements for
the degree of Doctor of Philosophy

Coral Gables, Florida

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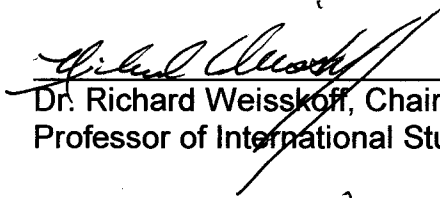
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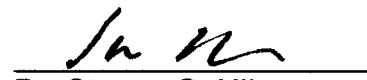
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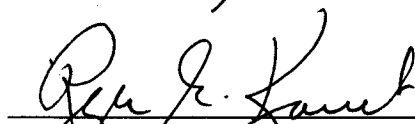
CONNECTING THE DOTS: A HISTORICAL AND POLITICAL ANALYSIS OF
ECONOMIC REFORM AND ITS RELATIONSHIP TO INVESTMENT AND
BUSINESS IN KAZAKHSTAN AND UZBEKISTAN


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This study combines the economic and the political transition literature in order to undertake a comprehensive analysis of the reform processes of Kazakhstan and Uzbekistan from 1991-2003. Information from interviews conducted with economists from the financial institutions as well as information from interviews conducted with representatives from the business community complemented the data analysis of economic reform. This dissertation uses precondition variables hypothesized to explain the differences in the reform processes of each country better than a focus on a country's political categorization (former Soviet elite).

The analysis of the strength of the pursuit of economic reforms by each leader was the strongest indicator as to whether reforms would be advanced or delayed. When there were instances of opposition (in Kazakhstan), Nazarbayev manipulated the political system in order to bring in supporters of his reform policies and to oust his opponents. In Uzbekistan, Karimov reversed reform policies when problems in the country's terms of trade did not bring in the needed revenue for the state. The level of turnover of the former Soviet elite (president

and governmental officials) does not explain the level of advancement of reforms because Nazarbayev is a member of the former Soviet elite. Kazakhstan's higher level of integration with Russia during the Soviet regime resulted in policies of more international economic orientation. Uzbekistan's lower level of integration resulted in less of a need to engage the international community.

The analysis from the results of the interviews with investor and business representatives indicated that each type of firm understood the variable of economic reform in different ways based on the type of risk the firm perceived as important to their investment or business decision. Additionally, while Uzbekistan's slower progress on economic reform affected its level of business it did not affect the number of firms doing business in the country. This was mainly because firms could secure the financing for the business through the Export-Import bank, or another foreign financing bank.

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Chapter 1: Introduction

The end of the Soviet Union and the subsequent emergence of fifteen independent republics resulted in unprecedented challenges for the fields of international economics, as well as political science. These were not simply heavily distorted market economies that required structural assistance; these economies had functioned without a traditional market structure (Winiiecki, 1995; World Bank, 1996). The early reform strategies advocated by economists recommended that each country undertake the following reforms as soon as possible: macroeconomic stabilization, liberalization policies, convertibility of the currency, and privatization (Fischer and Frankel, 1992, p. 38). As the subsequent analysis of the results from strategies pursued by different states demonstrates, the advanced reformers were also the states that had proceeded with political reform; a change to non-communist political leadership (Aslund, Boone, and Johnson, 1996; Fish 1998).

However, this categorization of political regime type does not explain the differences in economic policies followed by all of the transition economies. Recent studies (Abdelal, 2001; Tsygankov, 2001; Aslund, 2002) have incorporated additional variables including the influence of Soviet history, and other precondition indices deemed important to understanding developments in post-Soviet states. The inclusion of these types of pre-condition variables is

more likely to explain differences in the economic reform strategies undertaken by Kazakhstan and Uzbekistan.

Statement of the Problem

The purpose of this comparative study was to examine historic, geographic, and political issues in order to interpret the economic reform processes of Kazakhstan and Uzbekistan. The general question that this study attempted to answer was this one: Why has Kazakhstan continued with economic reform while Uzbekistan has not? The project will additionally examine the relationship between economic reform and investment. The purpose of this part of the study is to clarify whether economic reform areas were a factor in the decisions of firms to invest or conduct business in the case study countries.

Kazakhstan and Uzbekistan have had former communist leaders since each country's independence, but each country has continued with economic reforms at a vastly different pace. Kazakhstan has been grouped among the stronger reformers of the Commonwealth of Independent States (CIS) (IMF, 1997a; EBRD, 1999). Uzbekistan has been grouped among the later reformers of the CIS, as well as having a more gradual pace of reform than the other CIS (IMF, 1997b; EBRD, 1999). While Kazakhstan and Uzbekistan were former Soviet Union (fSU) republics, each state differed in its level of integration with Russia during the Soviet era. Kazakhstan and Uzbekistan have strong leaders, but leaders that have differed in the strength of their pursuit of economic reforms. Finally, each country has differed in the level of turnover of the former Soviet

elite. Therefore, a focus on these types of pre-condition variables is believed to have greater explanatory value in interpreting the reform processes of these countries.

The Significance of the Study

This type of analysis about political and historical factors that have influenced the economic reform processes of Kazakhstan and Uzbekistan is important to understanding reform in transition economies. Differences between countries in comparative analyses of economic progress consistently focus on broadly defined initial conditions, and a specific type of political regime type as determinants of the economic reform process. The comparative political literature is often lacking in concrete economic reform analysis. This study combined the economic literature with the political literature to develop a more complete framework for interpreting the reform processes of each country.

The choice of a *small-N* comparative study allows for more in-depth analysis of the political and historical factors in these countries that would not be possible with a *large-N* statistical analysis. De Melo, Denzier, Gelb and Tenev's (2001) *large-n* statistical study recognized and incorporated the analysis of initial conditions in the transition economies, and thus moved away from the focus on the political change during the transition.

However, the authors concluded that

Questions related to the importance of geography, culture, and history in the choice of reform paths are interesting and important, but they are beyond the scope of the article. (De Melo, Denzier, Gelb and Tenev, 2001, pp. 27-28)

Aslund's (2002) comprehensive study of the former Soviet bloc countries is a notable exception, in that he acknowledges the importance of issues such as culture, history, and politics as having influenced the economic development of these countries. This study also incorporates these variables and will therefore have greater explanatory power in furthering the understanding about differences in the economic reform processes of Kazakhstan and Uzbekistan.

Overview of the Methodology

This study uses a combination of methodologies to answer the research question. The choice of the comparative case study has allowed for the detailed analysis of a small number of cases. Elite interviews are used to complement the document analysis in a number of ways. The results from interviews with economists from the financial institutions provided additional information about reasons for each country's different approach to continuing with economic reform. The results from interviews with business and investor representatives provided evidence for determining a relationship between reform and investment/business decisions.

Organization of the Dissertation

The dissertation is organized into eight chapters. Chapter 2 provides an overview of the relevant literature of economic development as well as a review of the early economic strategies that the transition economies were encouraged

to follow. This review also incorporates the literature about the role of natural resources on reform efforts, as well as a discussion about the problem of corruption.

Chapter 3 describes the theoretical and research framework employed for this study. The chapter begins by stating the general research questions and includes a section that explains the selection of the cases for the study. Then, the development of the framework is outlined including the concepts that are used, and how the hypotheses are developed.

Chapter 4 presents the methods and data that were used for the study. This chapter describes the methodologies employed, as well as providing information about the primary and secondary sources of data. The chapter also provides information about the interviews with investor and business representatives. These sections include information about the characteristics of the firms chosen, and how the questionnaire was developed.

The next three chapters analyze the data and test the hypotheses. Chapter 5 illustrates the differences between the republics' integration levels with Russia during the Soviet era. Specifically, the integration levels are examined in geographic, political, and economic areas. This chapter also explains the importance of Uzbekistan's development as a primary producer of raw cotton. The analysis additionally focuses on the Brezhnev era during the Soviet Union and the influence of each republic's First Party Secretary during this period.

Chapter 6 emphasizes the importance of the role of the president in decisions about economic reforms. First, the analysis examines the relationship

of each president with the former First Party Secretary, including whether the president chose to continue with the policies implemented by the former secretary. Next, the relationship between the president and his early governmental officials (the elite) are comparatively reviewed with attention paid to the early reforms implemented by each government. Then, the chapter compares differences between the delay of economic reforms in Uzbekistan, and the advancement of economic reforms in Kazakhstan. This type of comparative analysis is possible through a careful and systematic analysis of data from chapters 5 and 6.

Chapter 7 then expands upon the previous analysis of economic reform by examining whether the implementation of the reforms, outlined in chapter 6, have influenced foreign investment or business decisions into either country. The analysis proceeds with a categorization of the results of the interviews with representatives by the types of investment or business that they conducted (natural resources, services firms, business firms) with the case study countries. The chapter then concludes with a comparison of each country's progress on the economic reform indicators deemed most important by investor and business representatives.

Chapter 8 summarizes the major findings about the differences in the economic reform processes of Kazakhstan and Uzbekistan. This chapter also reviews the relevance of the findings for other fSU transition economies, and discusses the limitations of this type of study. Finally, the chapter offers recommendations for future research and study.

Conclusion

The transition economies of the fSU, including Kazakhstan and Uzbekistan, are still in the process of continuing with economic reforms. This is evident by the very recent decision of the Uzbek government to abandon its multiple exchange rate regime, and agree to full convertibility of the currency on October 15, 2003. This dissertation has contributed to the development of a framework for interpreting the reform processes of Kazakhstan and Uzbekistan. This study also furthers the economic debate on reform by suggesting that specific areas of economic reform are more likely to positively influence investment and business decisions.

Chapter 2: Review of the Literature

The strategy for developing an appropriate framework for the transition economies to follow has come from economists, comparative specialists, and former Sovietologists. This chapter will first review some traditional theories on economic growth and development. These theories are likely to yield some insight into the specific developmental difficulties, or challenges, faced by some of the transition economies. Then, the main issues concerning the reform efforts of the transition economies will be discussed. The transition of these economies was (and is) a process. Therefore, this chapter is organized to review the early theories on the transition process, and then to review the most recent literature concerning reform efforts; including a focus on the Central Asian states.

Economic Growth and Development

Economists have written about conditions necessary for economic growth and development since the 1950's. Economic development theorists have also focused on how the presence of specific resources could influence the development process. Hirschman's (1959) linkage theory explained how different economic resources would affect the development of an economy. According to Hirschman's theory, the presence of forward linkages would be present in an economy that had an abundance of a primary resource, because investment would be focused on an industry that could then utilize that resource.

Backward linkages then, explain an economy's need, "...to supply through domestic production the inputs needed in that activity" (Hirschman p. 100).

Innis' (1954) staple theory adds to the understanding of linkage theory because his theory also focused on the importance of specific resources, and how they influenced the growth of an economy. Therefore, his theory of the importance of a "staple" for an economy has explained, "...the impact of export activity on (the) domestic economy and society" (Watkins, 1963, p. 144). Innis (1954) argued that the focus on a staple product could shape an industry, as well as form "the basis of economic development" for a country (p. 1). Both of these theories illustrate the affects that primary products could have on the process of economic development.

W. W. Rostow (1960) outlined stages that societies would have to go through to achieve economic growth. One of the stages for economic growth and development was also the attainment of a more modern society. What is less clear, especially from Rostow's thesis, is the process that a society should follow to move into this modern era.

Gerschenkron (1962) put forth the unconventional thesis that industrially "backward" countries developed differently from advanced countries, and that these countries could benefit to some degree from their late start (p. 7).¹

Gerschenkron explained that this could happen because these later economies would benefit from institutions that were not realized to be necessary in the

¹ The catch-up hypothesis is closely related to Gerschenkron's idea concerning the benefit of a late start. Abramovitz (1986) further developed Gerschenkron's theory with the hypothesis "...that being backward in level of productivity carries a potential for rapid advance" (p. 386).

previous developed economies. He also argued that a backward country's process of industrialization would vary depending on the degree of backwardness of the country when it began to industrialize. In essence, he theorized that there was a correlation between the degree of backwardness and that country's process of industrialization (Gerschenkron, 1962).

More recently, economists have analyzed the importance of structural issues as an important indicator of economic growth. Barro (1997) found that variables such as education, life expectancy, rule of law, and democracy influenced economic growth. He also discussed the "controversial" connection between political and economic freedom; and argued that democratic as well as authoritarian regimes had the potential to retard economic growth (Barro, 1997, pp. 49-50). Rodrik (1996) proclaimed that economic development policy should emphasize "fiscal rectitude, competitive exchange rates, free trade, privatization, undistorted market prices, and limited intervention" (p. 9). These elements of development were deemed important for developing as well as transition economies.

Early Economic Strategy

The early economic reform strategy that the former socialist economies were advised to follow was initially grouped into five main areas. Fisher and Frenkel (1992) stated that the countries should implement the following reforms as fast as possible and at the same time: macroeconomic stabilization; the liberalization of the prices of most goods; current account convertibility of the

currency; the creation of a social safety net; and privatization (p. 37). This method has commonly been referred to as the “big bang” approach, or shock therapy because it was believed that it was necessary to implement macroeconomic reforms and structural adjustment policies simultaneously (Fischer and Frankel, 1992, p. 38).

Lipton and Sachs (1990) explained the necessity that the transition process be both rapid and comprehensive, because the elements of the process were necessarily tied together. They stated, for example, that, “...structural reforms cannot work without a working price system; a working price system cannot be put in place without ending excess demand and creating a convertible currency...” (p. 99). Fischer and Gelb (1991) concurred that this type of comprehensive reform should not be done piecemeal, but rather should be undertaken as “groups of complementary policy reforms” (p. 101). Aslund (1995) also stressed the importance of currency convertibility and macroeconomic stabilization for the transition economies.

Junz (1991)² agreed with the undertaking of comprehensive reform policies. However, she cautioned against grouping all of these countries together and forgetting that they were different

...with respect to resource endowment and to the institutional and political capacity to support and sustain change; differences (which could) impact the structure and possible speed of economic transformation. (p. 177)

² Junz was referring to the Eastern European countries; however her insight is also relevant for the former Soviet Union countries.

Fischer and Gelb (1991) additionally stressed the point that each state would be different in implementing the details of a reform path due to differences in the political situation, and in the condition of the economy.

Later results from different reform strategies pursued indicated that the countries that had implemented and continued with reforms had performed better than those countries that were not advanced reformers (Aslund, 1995; World Bank, 1996; Guregen and Snoek et al., 1999; Fischer and Sahay, 2000). While this was not surprising, these advanced reformers were also the countries that had proceeded the fastest with political reforms; mainly the countries of Central and Eastern Europe and the Baltic States. One conclusion drawn from these advanced reformers was that it was the political reform coupled with the economic reform that led to the success of these countries.³

Economists from the World Bank later stated that, "(r)adical economic reform has proved easier when political change has been rapid and fundamental, as in much of the CEE and Baltic States" (World Bank 1996, p. 11). Comparative statistical analyses of these countries often then correlated the change in political leadership (non-communist) with economic reforms.

³ Another theory was that the geographic proximity to Western Europe (and to western markets) was another reason that these countries proceeded with reform more quickly than the former Soviet Union countries (Hanson 1995; Citrin and Lahiri 1995; Wolf 1999; De Melo, Denzier, Gelb and Tenev (2001).

Aslund, Boone and Johnson (henceforth ABJ) (1996) completed one of the first comparative statistical analyses of all the reform efforts of the post-communist states to determine how reform policy is affected by political considerations. ABJ find that there is a strong correlation between political regime and economic policies, and that in the countries that kept the former communist rulers reform was initially delayed regardless of the degree of democratization (1996, p. 223-224).

An important finding by ABJ (1996) was that anti-communist governments are more likely to implement reforms that will “break the extraordinary power of the former elite”; while governments controlled by the former communist elite may initially implement policies to enrich their supporters, and then pursue reform minded policies (p. 226-227). Related to this, ABJ (1996) proposed that the main reason that states implemented reform gradually could be determined by who gained power at the beginning of reform (through elections), and then what incentives the leaders had in making decisions about economic policy (p. 252-253). This second assessment by the authors is a more insightful analysis of determinants of reform efforts, by pointing out that leaders made economic decisions based on what they could gain through those policies.

Fish (1998) also conducted a comparative statistical analysis to identify the determinants of economic reform in post-communist countries. His goal was to explain the relative differences among these countries based on their extent of economic reform through 1995. The dependent variable for his study was comprised of two components: liberalization measures and measures of

privatization (Fish, 1998, p. 32).⁴ Fish finds that the most significant variable in determining economic reform is the “initial-elections” variable; indexed to explain whether communists or non-communists won, and if the elections were freely contested (Fish p. 48).

Therefore, he concludes from his study that, “...the outcome of the initial elections is the best predictor of the extent of economic reform as of the middle of the decade” (Fish, 1998, p. 57).⁵ These studies on the reform efforts of the post-communist countries are an important contribution to the literature on economic reform because they focus on the degree to which leaders affect the implementation of economic policies.

Initial Conditions, Reform, and Growth

Recent studies on transition economies have attempted to determine the relationship between initial conditions, reforms and economic growth. These studies placed less emphasis on the political dimensions affecting reform, and attempted to use other variables to determine economic growth and reform. Fischer, Sahay, and Vegh (1996) stated that an important factor in explaining growth and recession differences among these countries was the time it took a government to begin a stabilization program. Variables in the growth process for

⁴ These components have been used in many studies to examine economic reform in the former Soviet Union countries (see World Bank 1996; European Bank for Reconstruction and Development (EBRD) Transition Reports, various years).

⁵ It is important to emphasize that Fish's study only included reform efforts through 1995; and that many of the circumstances in these countries have changed since then.

their study included: macroeconomic policy stance, structural reforms, and official external assistance (Fischer, Sahay, and Vegh, 1996).

Havrylyshyn, Izvorski, and van Rooden (1998) confirmed their hypothesis that structural reform, macroeconomic stabilization and reducing government expenditures were instrumental for economic growth. This study also concluded that even countries with unfavorable initial conditions could compensate for this by implementing the other factors conducive to growth.

Wolf's (1999) study examined the "nexus" between initial conditions, strategy choice, and their relationship to growth (p. 6). He found that the countries that undertook more radical reform had higher growth rates; thereby concluding that reforms influence growth. Heybey (1999) also studied economic growth and the speed of reform and found that economic growth results in a quicker pace of reforms. Falcetti, Raiser, and Sanfey (2000) examined macroeconomic stabilization, initial conditions and structural reforms as determinants of growth. However, they did not find substantial evidence that countries in higher reform categories continued to have growth significant from that of countries in lower reform categories (p. 14).

One explanation for the discrepancy in determining a direct relationship between growth and reforms may stem from the difficulty in determining accurate output for the transition economies. Output is usually defined by measuring GDP growth. However, this has been a problem in measuring output for the transition economies because of underestimates of GDP in not capturing the output from

the non-state sector and from the unofficial economy (Fisher and Sahay, 2000, p. 4; Havrylyshyn, Wolf et al., 1999, p.7).⁶

de Melo, Denzier, Gelb and Tenev (henceforth MDGT) (2001) undertake to determine the importance of initial conditions in determining policies, as well as the impact of initial conditions on economic outcomes. The authors stated that previous research that had focused on Central and Eastern Europe and the FSU countries has been limited in that it has focused on the political transition and its affect on policy choices (MDGT, 2001, p. 2).⁷ Therefore, their study contributes to the study of the transition economies in that it focuses on political change, initial conditions, and reforms as factors related to economic performance.

MDGT (2001) concluded from their study that policy reform depends on initial conditions, political change and regional tensions. They also find evidence that economic performance (measured in terms of growth and inflation) depends on initial conditions, economic policies and regional tensions (p. 26). Furthermore, what is most significant in determining the speed and degree of economic liberalization is found to be political reform; which the authors state leads to the question of "...what determines political liberalization" (MGDT, 2001, p. 27).

⁶ Numerous studies have recommended caution in GDP data from these countries due to its unreliability (Lipton and Sachs, 1990; Fisher, Sahay, and Vegh, 1996; Berg et al., 1999; Falcetti, Raiser, and Sanfey, 2000). Kaufmann and Kaliberda (1996) and Johnson, Kaufmann and Shleifer (1997) attempted to correct the GDP data by using data for electricity consumption.

⁷ This was the predominant focus of studies by ABJ (1996) and Fish (1998).

Economic Reform in Central Asia

Scholars have examined reform in the Central Asian states due to the similarities among this regional group of states. Kaser (1997a) outlined the progress of five central Asian economies in areas including price liberalization and economic reform; emphasizing the strong ties each of these countries had to the Soviet Union. Henley and Assaf (1995) found that most of these governments had decided on a slow approach to economic reforms due to, "...weak political structures, social tensions, the threat of nationalism (and) ethnic rivalries" (pp. 235-236).⁸

Spoor (1995) examined agrarian reform in Uzbekistan and Kyrgyzstan and argued that instead of classifying transition countries as "slow" or "fast" reformers that economic reforms should instead be viewed through "...their political and institutional context" (p.59). Islamov (2001) has also argued that there has been too much emphasis placed on the "shock therapy" approach to transition for the Central Asian states without sufficient analysis on the initial conditions of these countries that influence reform policy. Abazov (1999) attributed the choices made by the government of Kyrgyzstan in choosing a transition strategy to factors including "...the legacy of its economic and political development during the Soviet era... and (the) post-Soviet political environment and leadership" (p. 201).⁹

⁸ In their study they cite Uzbekistan as a specific example of following a gradual approach to economic reforms.

⁹ A later work by Spoor also stressed an examination of each country's place in the FSU, along with political and social issues specific to each country in an analysis of economic performance, and reforms implemented (1997 p. 585).

Green and Bauer (1998) undertook a comparative study of the difficulties of the transition process for Kazakhstan and the Kyrgyzstan because of their similarities in undertaking a decisive approach to the transition process.¹⁰ Aslund (2003) also noted that Kazakhstan and Kyrgyzstan have been “leaders of reform” as compared to the other Central Asian states (p. 77). There have also been comparative studies of the economic transition of Kazakhstan and Uzbekistan. Kaser (1997b) examined the similarities in the early economic reform strategies of the two countries; including the criteria guiding each of the governments that, “...first, the ‘visible hand’ of the state is accorded a prominent role in marketization; and (that) secondly, reform outcomes should be egalitarian (p. 23).¹¹ Alam and Baneji (2000) also examined the transition strategies followed by Kazakhstan and Uzbekistan. They stated that these countries provided an interesting comparison due to their differences in transition strategies, and as they argued, their respective differences in economic outcomes. Alam and Baneji (2000) concluded that even though Kazakhstan has been dominant in the implementation and extent of policy reforms, that the

¹⁰ A comparative study of these countries is rather unique, considering the differences in the political categorization of the countries. However, Green and Bauer stated that while each country has both legislative and executive branches, that in reality both states have very strong one-person or one-party states in which the president does not face “organized domestic opposition to programs” (p. 350). For more on the issue of whether Kyrgyzstan can truly be considered the only democratic country in Central Asia; see Koldys (1997), specifically p. 4.

¹¹ It should be noted that Uzbekistan did not substantially reverse its reform efforts until late 1996 and early 1997. Kaser’s study is important, however, because it outlines the similarities pursued by both countries in their early economic reform efforts.

country had not been as superior in its economic performance as might have been expected.¹²

Natural Resources and Economic Reform

The presence of natural resources in transition economies has also been analyzed with regard to its effect on economic reform. MDGT (2001) noted that the indicator for the level of richness in natural resources is varied across the transition economies, and they argue that the presence of resources in some countries may not make the transition process easier.

They stated that

The resource rich countries of Central Asia, for example, have to surmount enormous production and logistical problems (pipeline transit rights) before realizing their oil and gas potential. In some cases, the availability of exportable energy resources may permit governments to delay reform (as it has in Azerbaijan and Turkmenistan). (MDGT, 2001, pp. 6-7)

Therefore, a country with large exportable primary commodities, such as oil, may choose to delay reform because of the large inflows of capital from the export of those commodities.

The transition economies have also implemented policies to gain from the export revenue potential of primary resources. For example, Berkowitz (2001)

¹² The authors do point out that some of their analysis relies on GDP data, which they and others have acknowledged may not be reliable. However, one notable omission in their analysis is a discussion of Uzbekistan's multiple exchange rate regime and how that could have affected their evaluation of the economic performance of Uzbekistan.

found that in the case of Russia, the spread between the world market price and the domestic price of oil could result in, "...a source of rent for corrupt bureaucrats and cash-strapped local and regional governments" (p. 314). Aslund (2002) also noted that rent-seeking (profit above the competitive market level) was "prominent in the whole region" of post-communist countries (p. 3). He cited Ukraine as the most flagrant example, and stated that Russia and Kazakhstan were examples of countries that had started reforms but were then "dominated by rent-seeking" (p. 4).

Hersh (2001) analyzed the business dealings of a US oil firm with Russia and Kazakhstan and concluded that corruption by both the executives of the firm, as well as governmental officials had occurred in the deals surrounding oil contracts. Therefore, there is the likelihood of corruption by post-Soviet leadership in business dealings in the natural resources sector. Kazakhstan and Uzbekistan received the same corruption rating in the Corruption Perception Index for 2003 (2.4 out of a possible 10 denoting a "highly clean state").¹³ Kazakhstan also participated in an Integrity Country Study Report, which detailed the country's progress on areas of civil society and corruption (National Integrity Systems 2001).¹⁴ While the authors acknowledged that the Kazakh government had been taking action to fight corruption, the actions were described as not yet "noticeable" (p. 5).¹⁵ However, it should be noted that there was no comparable

¹³ Data found at <http://www.transparency.org/cpi/2002>.

¹⁴ See index for Country Study Reports at <http://www.transparency.org>.

¹⁵ Ibid.,

country report available for Uzbekistan, and that Kazakhstan was at least more willing to provide information about transparency issues.

Economists have studied the effects on economies that benefit from substantial increases in foreign exchange due to the large inflows of capital from natural resources. “Dutch Disease” is the term used to explain what often happens in these economies that;

First, the influx of foreign exchange from higher export earnings creates a surplus of foreign currency which tends to drive down its price in the domestic currency... Second, higher income from booming primary exports also spurs faster domestic inflation (because the) ...additional income creates greater demand for goods and services in the economy. (Gillis, Perkins, Roemer, and Snodgrass, 1996, p. 477)

Economists have also studied why economies that are large resource exporters also suffer from slow growth; which more accurately explains the term “resource curse” (Ross 1999). Studies have also found that government expenditures increase with large oil revenues and that much of this spending is on sectors such as construction and services. These types of expenditures exacerbate the resource curse because these nontradable sectors are not a source of foreign exchange reserves (IMF Survey Dec. 2, 2002).¹⁶

Ross (1999) argued that it was more important to understand why governments would fail to take action to prevent some of the results of Dutch

¹⁶ Resource rich countries have also created funds to better manage their resource revenues. Stabilization funds are set up to minimize the effects of shortfalls from resource revenues, while Savings funds are designed to secure monies for later generations (Davis, Ossowski et al. 2001 #205 IMF). Kazakhstan established a National Oil Fund in 2000, which was noted in EBRD 2001, as a signal of “a growing awareness about the importance of good resource management” (p. 88).

Disease; because “(g)overnments play an exceptionally large role in the resource sectors of almost all developing countries and, at least in theory, have the policy tools to mitigate (those) hardships” (p. 307). Gelb and associates (1988) found that the volatility of oil prices most severely affected both oil exporting and importing countries. This unpredictability of the price of oil made it difficult for the governments to follow through on nontraded sector projects often in construction. Additionally they found that the poor agricultural performance of many of the countries was due to the shift of labor from the agriculture sector, and not from the classification of the sector as a traded sector (Gelb and associates, 1998, p. 142).

Sachs and Warner’s (1995) comparative study examined the relationship between natural resources and growth rates of 97 developing countries to examine whether countries rich in natural resources had significantly lower growth rates than countries that had lower natural resource based exports. They found that there was a negative correlation between natural resource abundance and growth. This relationship did not change even when variables measuring bureaucratic inefficiency and protectionist policies were included; indicators that have been believed to be additionally responsible for the resource curse.

Sachs and Warner (1995) also concluded that even with these findings, that governmental policies should not alter a country’s comparative advantage in the production of natural resources. The authors stated that “...government policies to promote non-resource industries would entail direct welfare costs of

their own, and these could easily be larger than the benefits from shifting out of natural resource industries” (p. 23).

Auty (1995) examined governmental policies and the economic growth of various mineral economies and concluded that the presence of these natural resources did represent a resource curse. Auty's (1998) later research focused specifically on Kazakhstan's potential as a mineral rich transition economy. He subsequently argued that the effects of Dutch Disease may hinder the economic transition of Kazakhstan, although he did point out that there were some encouraging developments for the country's transition.¹⁷

Davis (1995 and 1998) specifically examined a group of mineral based economies to determine if they provided evidence of a resource curse. He found that while some countries seemed to have suffered from the exploitation of minerals, that broadly speaking there was no evidence that the resource curse was applicable in all mineral economies. Davis concluded that the resource curse was dependent more on domestic economic factors (1995, p. 1776).

Karl (1997) theorized that the oil producing states often become “rentier state” regimes with weak and unaccountable state institutions, and that this type of regime (authoritarian or democratic) would be unlikely to institute sound economic policy (p. 190). Jones-Luong (2000) predicts that Kazakhstan's use of its energy sector resources may be beneficial socially and economically in the short term, but she believes that political instability and social and economic

¹⁷ These developments included the accelerated degree of economic reform since 1995, the country's diversified mineral endowment and the establishment of a Capital Development Fund (Auty, 1998, p. 248).

deterioration will be more likely in the future (p. 80). Therefore, while there is a substantial literature on a relationship between natural resources and reform efforts, most of the findings emphasize the role of the government in decisions about economic reform. Jones-Luong and Weinthal (2001) analyzed oil and gas development strategies in the energy rich Soviet successor states. They find that an analysis of domestic factors, based on the domestic constraints present in each state are most likely to determine a states' development strategy of its natural resources.

Foreign Direct Investment (FDI) has likely played a role in the reform efforts of the transition economies, however the current literature has not addressed the issue of a correlation between reform efforts and (FDI).¹⁸ Fischer and Gelb (1991) noted the importance of investment, stating that rules concerning foreign investment "... (were) desirable as an early part of the reform program" (pp. 101-102). Haverlyshyn et al. (1999) concluded that while there is a "relationship" between FDI and growth, they additionally stated, "... those factors that promote greater stabilization and reforms also attract foreign direct investment" (p. 18). Aslund (2002) agreed with this correlation between FDI per capita and growth and stated additionally that, "... rather than improving the investment climate, FDI requires that the investment climate is already good" (p. 434). Jones-Luong (2000) noted that the strategy Kazakhstan followed to

¹⁸ Hewko (2002) emphasizes this point with his statement that, "As noted earlier, foreign investment plays a significant role in creating demand for reform of legislation and enforcement institutions, something that the literature and international institutions seem largely to have ignored (p. 13).

develop its energy sector was significantly different than other states having natural resource endowments. She stated that

Whereas most such states choose to jealously guard these resources through full state ownership and control, Kazakhstan rapidly privatized the bulk of its energy sector and invited an unprecedented level of direct international involvement in the development, production, and export of its energy reserves. (pp. 79-80)

Meyer and Pind (1999) noted that the lack of studies on foreign investment into the fSU states have been due to the low amounts of investment into those countries. They also found that FDI amounts to these countries are determined by: degree of advancement in the transition, whether the country is resource rich, and degree of reform implementation (Meyer and Pind, 1999, p. 212). Dyker's (1995) early work on the resource potential of the oil and gas sectors of some of the fSU countries is an indicator that investors were in fact interested in investment in these resource areas. Finally, Moran's (1998; 1999) works on FDI for developing countries and economies in transition have explained the important role of the host country in attracting FDI.

Conclusion

The early conclusions from the studies of the transition process were that countries that were more successful in their transition to market economies also transitioned to more democratic systems; which lead many theorists to correlate political and economic reform. Many studies were then able to confirm a strong positive relationship between political and economic reform.

The purpose of this study is not to dispute the argument that political reform leads to economic reform; rather it suggests that there are likely other important factors involved in the implementation of economic reform. Literature (Falcetti, Raiser and Sanfey (2000); MDGT (2001); Islamov (2001) that focused on the significance of initial conditions, and its influence on reform efforts was an important shift away from the focus on the political transition. Recent studies also seem to indicate that a government's role in reform efforts should be considered in addition to whether a country has natural resources.

There also appear to be some discrepancies in the literature regarding whether post-communist countries engaged in economic reform must involve non-communist leaders. These differences concern ideas about whether the elite are capable of reforming, or if they will continue to implement policy to suit their own interests. A focus on the reform capabilities of the elite, including the president may be a more important issue, rather than whether the governing body is comprised of former communist leaders. This study will contribute to this debate since former communist leaders have ruled both Kazakhstan and Uzbekistan since independence.

Chapter 3: Theoretical and Research Framework

The review of the literature in Chapter 2 has demonstrated that it is necessary to combine concepts from the political as well as the economic literature on the transition economies in order to construct a more complete picture of the reform processes of these countries. The purpose of this chapter is to develop the theoretical and research framework that will be used for this project to better understand the economic reform processes of Kazakhstan and Uzbekistan. This framework will organize the focus of the study and will be used to answer the following four research questions:

- How and in what areas did a republics' level of integration with Russia during the Soviet regime influence its present economic orientation?
- Does the strength of a leader's pursuit of economic reform determine whether economic reforms will be continued?
- Does the continuation of the former Soviet elite in the leadership of a country lead to a lack of progress on economic reforms?
- Does progress on specific areas of economic reform lead to larger investment/business levels?

The chapter will first explain how the case study countries were selected. Then, the concepts derived from the political transition literature will be operationalized in order to measure the advancement or delay of reforms in each

country. The chapter will then conclude with a definition of the areas of economic reform to be examined in the project.

Selection of the Cases

Kazakhstan and Uzbekistan were selected as case studies because of their similarity on three variables: categorization of current leader (former communist first party secretary); adequate information for an analysis of economic progress; and no civil war. They were also selected due to their differences in the variables under investigation: progress on economic reform, and foreign investment levels. The other Central Asian states were eliminated from this study for the reasons explained below.

Kazakhstan and Uzbekistan began their status as independent countries with each country's former communist first party secretary leader; who then became president of each of the republics. Kyrgyzstan is the only Central Asian republic to have elected a president, Askar Akayev, who was not formerly the head of the Communist Party (Commission on Security and Cooperation in Europe 1992, p. 134). Therefore, the country did not have a comparable regime type to the case study countries.

Kazakhstan and Uzbekistan had both begun stabilization programs in 1994, and had adopted some type of exchange rate regime. Turkmenistan has not reached any agreements with the IMF, (or subsequently the World Bank) a stabilization program has not been started, and there is no documented

exchange rate regime (Fischer and Sahay, 2000, p. 35). Therefore, the country did not provide sufficient data for the dependent variable of economic reform.

Kazakhstan and Uzbekistan have not had internal civil strife to the degree that a civil war has resulted. Tajikistan has been involved in political strife with the start of a civil war in July of 1992. A peace agreement was not reached until June of 1997 (Izvorski, 1999, p. 6). Therefore, it would be difficult to analyze and reach any valid conclusions about the country's progress in economic reform efforts. The variables in which Kazakhstan and Uzbekistan differ are in progress in economic reform and investment levels. Therefore, these are the variables under investigation.

Differences in the Cases: Variables of Interest

Economic Reform

Table 3.1 shows the beginning reform efforts for Kazakhstan and Uzbekistan by month/year.

Table 3.1 Beginning Benchmarks of Reform

Country	Privatization (program started)	Price Liberalization (some prices)	Stabilization/ Economic Program (program started)
Kazakh.	1992	Jan. 1992	Jan. 1994
Uzbek.	1992	Jan. 1992	Nov. 1994

Sources: IMF Staff Country Reports, various years;
Fischer and Sahay, 2000, p. 35.

First attempts by each country to begin a privatization program and to liberalize prices have been noted as important benchmarks for the transition economies, and would then lead to stabilization policies (Havrylyshyn and McGettigan, 1999; Fischer and Sahay, 2000).

Table 3.2 indicates when these benchmarks of reform were completed, including the introduction of a new currency; as well as the dates that terms were reached with the IMF for conditional financial arrangements.

Table 3.2 Completed Benchmarks of Reform

Country	Price Liberalization	New Currency *Convert. Currency	1 st SBA	2 nd SBA	EFF	SBA Susp. By IMF
Kazakh.	Nov 1994	Nov 1993 *July 1996	Jan 1994	June 1995	July 1996	
Uzbek.	Still in progress**	Jan 1994 *Oct 2003	Dec 1995			Nov 1996

Sources: IMF Press Releases, various years; IMF Staff Country Reports, various years; Fischer and Sahay, 2000, p. 35; EBRD, 2001, pp. 158, 210.

**Most prices were liberalized by the end of 1996, except for prices that were administered by the government (energy, rent communal services, telecommunications). The state order system was still in effect for cotton and grain (EBRD, 1997, p. 211).

The dates that terms were reached for these lending arrangements are important distinctions between the countries for two reasons. First, a country's use of IMF resources is "...conditional on the member's adoption and implementation of an economic program that promises progress toward sustained growth and balance of payments viability" (Rodlauer, 1995, p. 109). Kazakhstan was able to secure a

Stand-by Arrangement (SBA) with the Fund earlier than Uzbekistan, and Kazakhstan did not have its lending arrangements suspended by the Fund (see Table 3.2). Second, the order of the lending arrangements by the Fund is indicative of progress on economic reforms. The Extended Fund Facility (EFF) has a longer repayment period (than the SBA) but this facility “require(s) more action in the structural area than was typical of stand-by arrangements” (IMF Review of Fund Facilities – Preliminary Considerations, March 2, 2000, p. 10). Fischer (1997) pointed out that this structure was also the lending pattern of the IMF with regards to the transition economies with the statement that

An emerging pattern in the transition economies is for countries to move from a stand-by, which emphasizes stabilization, to an EFF, which shifts the emphasis to structural reforms while maintaining macroeconomic stability (p. 23)

Both countries began their reform programs almost in tandem, but then diverged markedly, most notably in 1996. Therefore, the analysis of the countries will examine the progress of each country on economic reform, including why Uzbekistan halted economic reform and why Kazakhstan continued with economic reform.

Investment

Kazakhstan has received the largest cumulative inflows of FDI of the CAS (see Table 3.3).

Table 3.3 FDI Inflows to CAS and Resource Endowment Ranking (in million US\$)

Country	Resource Rank	1994	1995	1996	1997	1998	1999	2000	2001 (est.)	Cum.
Kazakhstan	Rich	635	964	1,137	1,321	1,136	1,584	1,245	2,760	10,782
Uzbekistan	Moderate	73	-24	90	167	140	121	73	71	711
Kyrgyzstan	Poor	38	96	84	84	109	38	-6	22	465
Turkmenistan	Rich	103	233	108	108	62	89	126	133	962
Tajikistan	Poor	12	13	18	18	25	21	24	9	140

Data taken from Meyer and Pind, 1999; p. 203; IMF World Economic Outlook, 2000; EBRD, 2001, p. 68; EBRD, 2002, p. 67.

However, Kazakhstan's foreign investment has largely been concentrated in the oil and gas sector. This sector has had the largest percent share of foreign investment in Kazakhstan for the years 1993-96, and each individual year thereafter through 2001 (IMF, 2002; 2003; pp. 99; 104). Uzbekistan has received the third largest inflows of foreign investment of the CAS. Uzbekistan is also endowed with "substantial natural resources" including petroleum, natural gas and coal. The country was also the second largest producer of gold in the fSU, and the eighth largest producer of gold in the world for the years 1992-1998 (IMF, Uzbekistan, 1992, p.1; CRB Commodity Yearbook 2000, p.111). The presence of these natural resources explains the country's resource ranking of

“moderate.” Therefore, it is likely that Uzbekistan has also received foreign investment for its natural resource sectors.¹⁹

Kazakhstan and Uzbekistan provide good case studies in analyzing the relationship between economic reform and investment due to the differences between the countries in these two areas. The analysis will examine whether economic reforms are correlated with foreign investment/business levels in these countries. Specifically, the project will look at whether Kazakhstan’s economic reforms are correlated with the country’s higher investment/business levels.

Theoretical Framework

As established earlier, the economic literature about reform in transition economies neglected other important variables that may better explain differences in the economic reform processes of these countries. This project will operationalize three concepts hypothesized to interpret the reform processes of each country. The three concepts are: the level of integration during the Soviet regime, the role of the elite, and the leader’s pursuit of economic reforms.

¹⁹ Uzbekistan’s governmental authorities did not make this information available, at least in public information in Staff Country Reports published by the IMF. However, information that the government does make available about foreign investment in economic sectors is suspect. Information provided to me by an official at the Embassy of Uzbekistan indicated that the industrial sector received the largest share of foreign investment and credits at 69.3%. The second largest sector was transportation at 12.4%; and the sector of “others” was third at 11.7%. This “others” sector also had the largest number of enterprises with foreign investment at 2,040 (Information provided by the Embassy of the Republic of Uzbekistan, 2001).

Independent Variables

The Level of Integration during the Soviet Regime

The different experience of the post-Soviet countries during the Soviet era has likely influenced their policy decisions and their general framework as independent states. Abdelal (2001) and Tsygankov (2001) found that nationalism and national identity were strong factors in determining the policy choices of post-Soviet states, and that these identities were formed before the end of the Soviet Union.

Abdelal found in his analysis of the histories of the fSU

... that post-Soviet societies differed a great deal in the interpretations of a common Soviet past. According to some, the Soviet Union had been an empire that subjugated their nations and attempted to crush their distinctive identities. (Abdelal, 2001, p. viii)

However, these studies did not examine how these indicators of integration could influence differences in the economic reform processes of the independent states. Carrere d' Encausse (1995) also emphasized the importance of issues concerning nationality and diversity in analyzing the Soviet era. Aslund (2002) stressed that while the Soviet Union was considered one country, that in actuality the republics were different (from Central and Eastern Europe) in areas of culture, history and politics (p. 57). He also concluded that, "...diverse economic policies and outcomes were to be expected" due to regime differences (Aslund, 2002, p. 67).

Many of Olcott's works (1995; 1996²⁰; 1999) on Kazakhstan have stressed that it is important to consider the relationship between Kazakhstan and Russia in analyzing reform efforts due to the unique demographics in Kazakhstan regarding the high ratio of Russians to Kazakhs.²¹ Khazanov (1995) also noted the importance of the unique demographic situation in Kazakhstan and found that during the Soviet regime, the Kazakh political elite were given "...the right to run internal affairs in Kazakhstan and to distribute preferential treatment and high-level jobs" (p. 252). However, Khazanov (1995) concludes that these circumstances would likely lead to further "ethnic tension" within the republic (p. 258). Gleason (1997) and others (Pomfret, 1995; Alexandrov, 1999; Capisani, 2000) have pointed out that in addition to the unique demographic situation, Kazakhstan was also more integrated to Russia in areas including physical infrastructure than the other Central Asian states.

The *level of integration during the Soviet era* is believed to influence the present international economic orientation of the regime. Indicators of integration levels will include an analysis of the degree and type of integration with Russia (geographic, political, and economic). Indicators used to analyze integration levels will also include differences during the tenures of First Party Secretaries Dinmukhamed Kunaev and Sharaf Rashidov, and significant events during the tenure of each during the Brezhnev era. Bunce (1980, 1983), for example, has argued that significant political and economic change occurred during the

²⁰ Olcott's chapter in this edited volume was titled "Kazakhstan: Living with a Hegemon" (Olcott 1996, p. 57-85).

²¹ Russians were a larger group than ethnic Kazak's from the 1960's through the 1980's. In 1991, the ethnic composition was 39.7% Kazak and 37.8% Russian (Pomfret, 1995 p. 21; 78).

Brezhnev era. Critchlow (1991a) and Carlisle (1991) have reviewed the importance of the Brezhnev era during the formulation of the Uzbek elite, and the policies of Rashidov when he was the former First Party Secretary. This variable, while complex, may explain the isolation of the Uzbeks during the Soviet era to the lack of international economic orientation of the country. Conversely, the history of integration between Kazakhstan and Russia may have influenced the higher international economic orientation of the country.

H1: A high level of integration during the Soviet regime (with Russia) will result in more international economic orientation in the post-Soviet era.

Strength of the Leader's Pursuit of Reforms

Hellmann (1998) contributed to the necessity of examining the leaders' role in economic policy by formulating a theory about why leaders would implement partial economic reform. He argued that opponents of post-communist reform were the net winners in the reform process, and that as such they did not want to give up their gains. Hellman (1998) stated that these winners have not opposed the reform efforts, rather

they have frequently attempted to block specific advances in the reform process that threaten to eliminate the special advantages and marked distortions upon which their own early reform gains were based. Instead of forming a constituency in support of advancing reforms, the short-term winners have often sought to stall the economy in a *partial reform equilibrium* that generates concentrated rents for themselves, while imposing high costs on the rest of society. (pp. 204-205)

This analysis of determinants of economic reform, and of the role that the leaders play in reform efforts, likely explains why economic reform was not continued in some post-communist states.

Critchlow (1991a) explained the necessity of examining changes in the nationality of Uzbek politics; especially during the Brezhnev era to understand the political and economic development of Uzbekistan. He argued that Uzbek politics was less dominated by Russians during this era, and that Rashidov's long tenure (1959-1983) allowed him to appoint loyal followers at all levels of the government (Critchlow, 1991a, p. 18-21). Critchlow (1991b) and Carlisle (1991) pointed out that Moscow's later attempts to discredit the Uzbek elite in effect empowered them among the people of Uzbekistan who more easily identified with their own ethnic group, and continued the development of a strong Uzbek national identity. Critchlow (1991a) emphasized the importance of this development for future Uzbek politics with his statement that

In retrospect, it now seems clear that the turning-point for Soviet power in Uzbekistan, the beginning of the decline of Moscow's authority, was the offensive against the native elites led by Gorbachev at the Party Congress in 1986. (p. 52)

Fierman (1997) explained that the attempts to discredit the elite from the Rashidov era did not succeed, and that public attacks on the "old political guard ended when Karimov was appointed as first party secretary in 1989" (p. 339).

Karimov's drive to show solidarity with the Uzbek leadership from the former Rashidov era, began with the rehabilitation of Rashidov, as well as a more

favorable portrayal of those involved in the “cotton affair”²² (Fierman, 1997). Scholars have stated that Karimov and the government leadership pursued these policies to promote Uzbek nationalism, and to show that former party leaders were looking out for the interests of Uzbekistan (Gleason, 1997²³; Melvin, 2000; Capisani, 2000). Therefore, former communist party leaders would now be viewed as acting in the interests of Uzbekistan. This is an important consideration in the influence of the leadership’s role in shaping economic reform.

Colton and Tucker’s (1995) work included chapters on elite development in post-Soviet states, as well as an analysis of how the people viewed their elite leadership. Lubin’s (1995) chapter in this work specifically examined the views of the Kazakh and Uzbek people on their respective leaders. Lubin’s surveys confirmed that the desire of the populace for strong leadership was found in the widespread support seen for President Karimov and Nazarbayev (1995, p. 224). Gleason (2001a) elaborated on the importance of strong leadership in the implementation of policies with his statement that in Central Asian politics “...individual leaders’ preferences played a significant role in the selection and implementation of policies” (p. 169). Analyses of these countries should then focus on the leaders, the elite, and their roles in the reform process; not solely on whether these groups were former communists.

²² The cotton affair refers to the corruption scandal whereby Moscow paid for amounts of raw cotton from Uzbekistan that were never delivered. It was alleged that Uzbek officials at all levels of the republics’ government under Rashidov were involved in the bribery and corruption. The implications of this event for the future development of Uzbekistan will be reviewed in greater detail in chapter 5. Also see; Critchlow, 1991a, pp. 40-45; Kirimli, 1997.

²³ Gleason points out that Karimov’s decree pardoning those involved in the cotton affair happened only days after he had been given the authority over all court proceedings in Uzbekistan at the end of 1991 (p.118).

The *leader's pursuit of economic reforms* in each of these countries has influenced the reform process through the advancement or delay of reforms. Studies of post-communist economic reform efforts have included analyses of the leaders in the states, and their role in the reform process. However, as Hellman's (1998) study illustrated, it may be more insightful to examine the motivations for economic reform, rather than to solely base reasons for economic reform on the "democratic/non-communist" variable. Dawisha and Parrott's (1997) work compared degrees of political change in post-communist states, with a focus on the elite and their use of power in the transformation process. Olcott's (1997) chapter in this volume discussed the development of the "new elite" in Kazakhstan. She stated that economic reform and privatization had "shift(ed) economic advantage away from the Soviet-era elite, the nomenklatura, to a new elite" (Olcott, 1997, p. 224).

A leader's influence over the reform process is most evident in the degrees of control over the members of each country's legislative body. Indicators of the leader's pursuit of reforms will include the number of times the president has tried to disband the legislature, and the type of presidential decrees and laws issued that concern an area of economic reform. Presidential decrees are often an indicator of the belief by a president that the measure would not pass if submitted to the legislature. Parrish (1998) found that some of the most important economic reforms issued under Yeltsin were issued as presidential decrees.

H2: The stronger the pursuit of economic reforms by the country's leader the higher the level of advancement of reforms.

Role of the Elite

Crawford and Lijphart (1995) briefly outlined two approaches to understanding the elite; defined as a small group of people who had the largest share of political power under communism (p. 181). The first approach, the “legacies approach” states that if the same group of people remain powerful and influential, then this elite group, “...will work to establish institutions in the post-Communist environment that are expected to contribute to their own future success” (Crawford and Lijphart, 1995, p. 181).²⁴ The second approach, the “liberalization approach” focuses instead on the importance of new emerging markets and political participation as more important for the political process. This approach argues that these institutions will alter the behavior of all of the powerful groups; therefore it does not matter if post-communists hold positions of power because they will not act in the same manner.

Higley, Kullberg and Pakulski (1996) support the underlying premise of the liberalization approach that change is possible with the old elite in power. These authors stress the point that some elites were able to change and adapt to new political and economic circumstances. The authors believed that this adaptability could be traced back to their changing attitudes before the end of communism (Higley, Kullberg and Pakulski, 1996, p. 136). A significant finding by Jones-Luong (2002) about the elite in three Central Asian countries was that

²⁴ See Jowitt (1992), for an additional theory on the difficulties of institutional change in Eastern Europe and the fSU.

elites adopt political reform (and institutional change) based on whether the reform enhances or preserves their own power.

The elite in some countries are best understood through the analysis of the “legacies approach.” McFaul (1995) and Aslund (1997) described how Russia’s elite successfully resisted economic reform because it would hurt their own interests. Lane (1996) examined the role of the Soviet political elite in the dissolution of the Soviet Union, and determined that the elite were not a unified force, but rather were divided on ideas about policy change.

The *elite* are defined as the group of people who hold the largest share of political and/or economic power. The relationship between the elite and the president will be examined based on whether the elite supported a president’s economic policies. Roeder (1994) and Melvin (2000) noted that in Uzbekistan the post-communist parliament was as compliant as during the Soviet era in passing measures introduced by the government. Gleason (1997) and Olcott (1995) conversely emphasized that Nazarbayev disbanded the parliament in Kazakhstan, also comprised of the former elite, largely due to its members’ resistance to implementing reforms. Specific indicators used to determine the degree of influence of the elite will include; the continuation of policies under former First Party secretaries, and the frequency in turn over of state and government officials.²⁵

H3: A high level of turnover of the former Soviet elite will result in the advancement of reforms.

²⁵ Hellman (1998) suggests that partial reforms benefit the former communist elite and that one way to measure their power is to examine to what extent there has been personnel turn over in key economic sectors or government positions (p. 229).

Dependent Variable

Economic Reform

Indices used to measure economic reform are varied and often depend on the specific areas the researcher wishes to examine.²⁶ Fisher and Frenkel (1992); Lipton and Sachs (1990); and Fischer and Gelb's (1991) early assessment of the transition economies was that they should implement certain reforms immediately such as; macroeconomic stabilization, liberalization of prices, convertibility of the currency, the creation of a social safety net, and privatization.

One of the most comprehensive comparative analyses done of economic reform in the former socialist states is the Transition Report published annually by the European Bank for Reconstruction and Development (EBRD). This organization also publishes a classification system in the Reports that rank transition indicators for areas of economic reform including: progress on scale of privatization, price liberalization, and trade and foreign exchange system and financial institutions (EBRD Transition Reports, 1994 -).

Interviews at the IMF were also conducted to determine in what areas of economic reform the countries most differed. These economists agreed that the areas that Kazakhstan had implemented the broadest economic reforms were in the liberalization of prices, introducing their own currency and that the most important step was the complete convertibility of the currency (Interview, IMF economists, July 9, 2002). Uzbekistan was rated as second to last among the

²⁶ Aslund (2002) for example, focuses on the fact that each fSU country had very different political factors that would be important for successful economic reforms.

Central Asian states in the implementation of economic reforms (Turkmenistan was last), and the country diverged from Kazakhstan the most sharply on the access to the foreign exchange market and convertibility of the currency (Interview, IMF economists, July 9, 2002).

Economic reform as the dependent variable will be examined in four areas: progress in reforming the trade and foreign exchange system; progress on privatization; laws on foreign investment; and the degree of reform undertaken in the agriculture, and energy sectors. Early assessments by economists at the World Bank were that each country had potential output and export growth in each of these sectors (World Bank 1993a; World Bank 1993b).²⁷ However, each of the country studies stressed that gains in these sectors would require substantial reforms. Analysis of sectoral reform will focus on the degree of reforms undertaken in each sector.

The second part of this project continues the analysis of the broad framework of economic reform and further examines the relationship between reform and investment. Specifically, what if any, areas of economic reform have been a factor in the investment, or types of investment in the two countries. As reviewed in chapter 2, there is a large literature that discusses the relationship between a country's presence of natural resources and its relation to economic reform. This was also one of the issues discussed in the interviews with the IMF

²⁷ Bank economists noted that the predominance of the agricultural sector in Kazakhstan (second largest in 1991) was more the result of central planning, and not due to the country's comparative advantage in that sector. Though they do note that reforms in the sector would contribute to overall reform efforts (World Bank 1993a, p. 130-143).

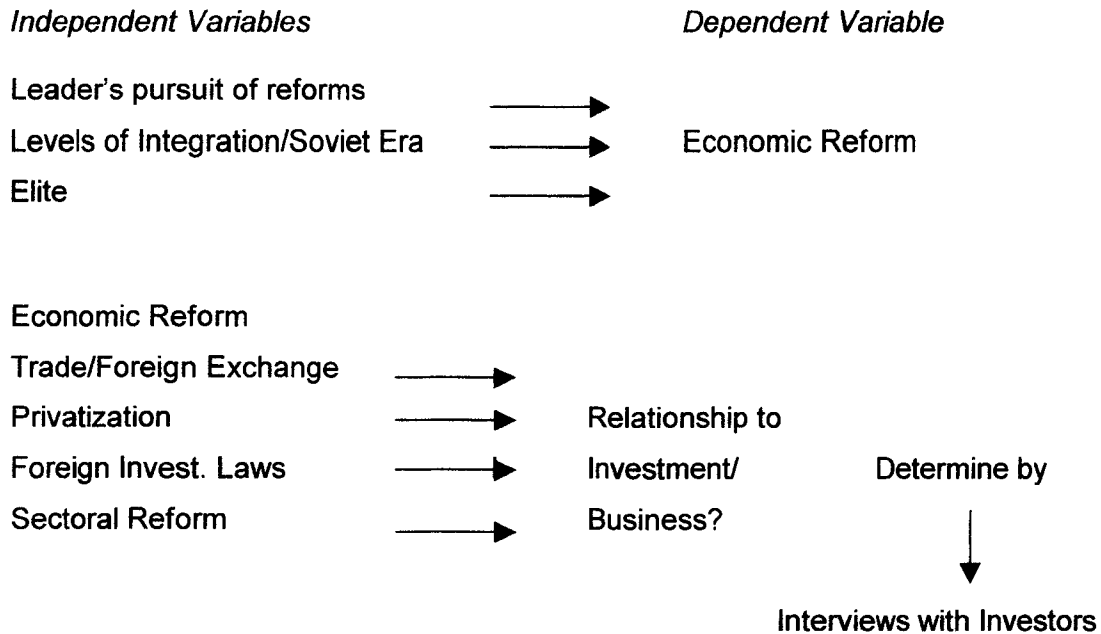
and World Bank economists. The specific issue that was discussed was whether the presence of natural resources affects economic reforms.

In an interview with an IMF economist, the interviewee stated that reform had no connection with natural resources, and that it was a difference of political attitudes, and differences between the presidents of Kazakhstan and Uzbekistan that had influenced differences in reforms (Interview, IMF economist, July 9 (b), 2002). In an interview with a World Bank economist, the interviewee also stated that the president's role in reform was important, and that Karimov may have viewed the implementation of economic liberalization policies as a loss of his power (Interview, World Bank economist, July 12, 2002). One economist stated that, while investors are interested in natural resources, issues of currency convertibility (in Uzbekistan) would need to be resolved before they would be willing to invest (Interview, IMF economists, July 9 (a), 2002). This interviewee also remarked that Uzbekistan may have higher reserves of oil than is currently realized, but that it was difficult to ascertain because the reserves had not been adequately explored (Interview, IMF economists, July 9 (a), 2002). Interviews with investor and business representatives will answer questions about whether investors considered economic reforms in their decision to invest or conduct business in either country, for natural resources as well as for other types of investment and business. The interviews will also determine whether Kazakhstan's larger investment amounts in the oil and gas sector were related to its reform efforts, or whether investors would overlook reforms when considering investment for natural resources.

H4: The success of economic reforms explains the larger foreign investment/business levels.

Figure 3.1 depicts the theoretical framework in a more concise form.

Figure 3.1 Theoretical Framework



Conclusion

The differences in the reform processes of Kazakhstan and Uzbekistan will be better understood through the use of the theoretical and research framework described in this chapter. This type of framework will produce new information about why one transition economy has continued with reform (Kazakhstan) and why one country did not (Uzbekistan). The second part of this project will also produce evidence about whether specific areas of economic reform in these case study countries have influenced amounts of

investment/business in the countries. The following chapter will describe in greater detail the methods that will be used in the project as well as the primary and secondary sources of data to be employed.

Chapter 4: Methodology and Data

Chapter 3 outlined the theoretical framework that will be used to explain the differences about progress in economic reform for the case study countries. The comparative case study and elite interview methods will be used for this project. This combination of methodologies will allow for an in-depth comparison of Kazakhstan and Uzbekistan to answer the questions concerning the continuation of economic reforms, and the relationship between reforms and foreign investment and business.

Research Methods

A comparative case study design is more beneficial than a single case study design because it allows a theory to be tested more than one time (Johnson and Joslyn, 1995, p. 146-147). King, Keohane, and Verba (1994) explained that comparative case studies can produce “valid causal inferences” when a systematic collection of the data is employed (p. 45). Lijphart (1971) also outlined the benefits of the comparative method when there are a sufficient number of variables that can be held constant, while the variables under investigation are dissimilar.²⁸ Collier (1991) additionally pointed out the advantages of small-*N* analysis, since it allows for a focus on a few cases, versus a statistical analysis of many cases. George and McKeown (1985) also

²⁸Also see, Mill (1961) and his framework for Method of Agreement and Method of Difference, pp. 253-259.

explained that a *small-N* design was appropriate when data collection was structured and focused.

Interviews with economists from the financial institutions (IMF and World Bank) will add to the projects' depth of understanding of the process of economic reforms. Interviews with investor and business representatives will answer questions concerning whether areas of economic reform were considerations by investors. Elite interviews are different from survey research because elites by virtue of their knowledge about a topic, are, "...given special, non-standardized treatment" (Dexter, 1970, p. 5). Therefore, interviews with these individuals will produce knowledge about these countries that could not be discovered through the use of other secondary sources.

Elite interviews also allow more flexibility than surveys because they allow the interviewees to give their own assessments of the situation (Dexter, 1970, pp. 5-7). Johnson and Joslyn (1995) noted that elite interviewing often provides researchers with a variety of perspectives, and a more thorough understanding of political phenomena (p. 265). Aberbach and Rockman (2002) discussed the value of elite interviews and noted that interviews were important in knowing "...what a set of people think, or how they interpret an event or series of events..." (p. 673). Elite interviews will comprise a substantial part of the research project.

Secondary Data Sources

Secondary data sources provide necessary information in the areas of economic reform, and in the Soviet and post-Soviet histories of each country. The Foreign Broadcast Information Service (FBIS) provides translated radio news sources on events happening in the republics (including personnel changes) and on events between the republics and Moscow. The service is provided by the US State Department and provides information both during and after the Soviet period, beginning in January of 1971.

Radio Free Europe/Radio Liberty RFE/RL (www.rferl.org) compiles daily reports of developments in Eastern Europe, Russia, the Caucasus and Central Asia, beginning in April of 1997. RFE/RL Central Asia provides a weekly survey of events in Central Asian states and includes reports of televised events and radio broadcasts, beginning in July 2001. Russia and Eurasia Facts and Figures Annual 1993- (formerly USSR Facts and Figures Annual 1977-1992) compiles information from various sources, including newspapers and FBIS. Information is provided on each republic and provides economic and political indicators. There is also a section on the chronology of events for the year, and a section on persons in positions in the government.²⁹

Accurate statistical information is generally difficult to find for the former Soviet republics. One problem is that not all republics' statistical agencies compile the same information, or by using the same methodologies.³⁰ The

²⁹ Information on positions in the government first appeared in the 1993 edition, and noted the governmental leadership for November of 1992 for the republics.

³⁰ Uzbekistan and Belarus' lack of progress on economic reform has carried over into the lack of reform of their statistical agencies.

Commonwealth of Independent States Statistical Yearbook (2002) provides comparative information on all the former Soviet republics; including information on economic, environmental and societal indices. The information in this volume contains information from 1991-2001 (2002 for some indicators). Statistical Yearbooks of Kazakhstan (various years) provides information in more detail about specifics of the country, and uses some indices that would not be possible in comparison with Uzbekistan. World Bank Country Study's (1993) were published for each country and provide an excellent early analysis of areas of reform needed, including reforms needed in specific economic sectors.

IMF Staff Country Reports (various years) identify trends in the progress of economic reform and also provide macroeconomic information on trade and investment. World Bank publications including discussion papers and technical papers analyze data on the Central Asian region specifically, and focus on reform in economic sectors such as energy and agriculture. EBRD annual Transition Reports (1994 -) cover the former communist countries and review progress on the transitions of these economies from planned to market based. This publication also includes comprehensive transition indicators in areas of enterprises, markets and trade and financial institutions. The Freedom House Nations in Transit publication reviews indicators of democratization, and political and economic progress for the former communist countries.

Sources were also used that focus almost exclusively on types of investment, laws and decrees related to investment, and on business and investor information. The OECD published Investment Guides for Kazakhstan

and Uzbekistan (1998 and 1996 respectively). These guides overview progress on investment legislation and include detailed information on laws and decrees passed in each country that specifically relate to investment legislation. The original laws and decrees relating to foreign investment passed by each country in various years were then analyzed. The EBRD published Investment Profiles (2001) on each country and includes comprehensive information on the investment climate, and major sectors of the economy. Finally, the US Department of Commerce maintains a web site, the Business Information Service for the Newly Independent States, (www.bisnis.doc.gov) which provides information including economic trends, upcoming projects and information for potential investors about countries including Kazakhstan and Uzbekistan.

While these sources provide important comparative economic and political information, they lack coverage of many of the in-depth issues that are key to understanding differences in the economic reform processes of these countries. Additionally, the sources on differences between reform and investment in the two countries could only generalize about what issues investors considered in their investment/business decisions in these countries. Therefore, elite interviews were necessary for a more complete picture of reform processes and considerations by representatives for the investment/business decisions.

Primary Data Sources

Interviews

Economic and political factors dictated that the International Financial Institutions would be the primary institutions that would advise these countries in their transition (Crockett, 1992; Zecchini, 1995). Therefore, interviews with economists from these institutions would be imperative in order to understand the reform processes of each country. Interviews with IMF and World Bank economists were conducted in June 2001, and July 2002. The interviews from these trips yielded specific information about the choice of the cases (June 2001), as well as specific information about reform implementation or lack thereof, as discussed above (mainly July 2002). Interviews at the IMF were held with economists who are/were mission chiefs and desk economists for Kazakhstan and Uzbekistan, as well as other economists. Interviews at the World Bank were held with economists who are/were working with the Central Asian states or with the other fSU transition countries. Interviews with IMF and World Bank economists were also conducted in October and November of 2003.³¹

Interviews were also conducted with trade officials, and other persons knowledgeable about the countries, not associated with the financial institutions in July 2002, and in September and October 2003. Interviews were conducted with officials from: the Embassy of Uzbekistan, the Embassy of Kazakhstan, the American Uzbekistan Chamber of Commerce, researchers at DRI-WEFA

³¹ World Bank economists that were previously interviewed were on assignment out of the country during my stay in Washington and returned during my last week in residence. A phone interview was subsequently conducted in November 2003.

(formerly PlanEcon), the Kazakhstan Business Association, Export-Import Bank, and the U.S. Department of Commerce.³²

Investor/Business Interviews

Interviews with investor and business representatives were conducted to determine if (a) representatives considered economic reforms in their decision to invest or conduct business in either country (b) if there is a relationship between economic reform and foreign direct investment and (b) if areas of economic reform were a consideration in investment for natural resources.

Representatives of twenty-three firms³³ having offices or corporate headquarters in the Washington, D.C. area were contacted requesting an interview between September and October 2003. Interviews were conducted with representatives of twenty firms. A representative of one firm declined to participate, and representatives from two firms never gave an answer about participating or declining after numerous follow-up attempts.³⁴ Numerous firms have offices or headquarters in Washington, likely due to its location as the capitol, as well as the hub of government activity.

³² Phone calls were made to a representative at OPIC (the Overseas Private Investment Corporation) requesting an interview as well as additional information. A preliminary day and time was established for a phone interview, which was not forthcoming and subsequent phone calls were not returned.

³³ The original disclosure form stated that anonymity would be given to each representative that was interviewed, and that only the name of the firm would be listed. However, a large number of representatives stated that they would only grant the interview if the firms' name were omitted as well. Therefore, firms will be categorized based on their sector or area of investment. The results from the interviews are presented in Chapter 7.

³⁴ Non-response bias does not appear to be a factor in the interviews because "...the degree to which those who refuse(d) to be interviewed (do not) differ from those who were successfully contacted and interviewed (Goldstein, 2002, p. 672). Two of the four representatives of firms who refused to be interviewed did comprise firms that conduct business in both countries. However, four firms that conduct business in both countries were contacted and interviewed successfully.

Firms were selected for participation based on many criteria. Investment and or business in the case study countries has been for the oil and gas sectors, including oil services firms, the agricultural sector, minerals sector, aerospace and consumer goods sector. Therefore, firms involved in these sectors were contacted. Firms were identified using the following information: authors' previous information about investment in the countries; information gathered from officials from each Embassy; lists of firms from publications from business associations; and firms named during previous interviews. Firms that were contacted either had investment in one or both countries, or the firm conducts business in one or both countries.

Interviews were conducted with persons having titles of Director of International Operations; Director of Government Relations/Affairs; Director of Corporate International Business Development and Manager of International Governmental Relations/ International Relations. The interviews lasted from between 45 minutes to two hours, with most interviews lasting about one hour. In some instances, representatives of Washington offices stated that they were not the best person to conduct the interview with and personal interviews were not possible. In these cases other interview techniques were used. Five phone interviews were conducted with a representative from the corporate headquarters of the firm. In three other cases, direct contact was made with the firms' representative in the Central Asian region.

Characteristics of Firms

US firms were contacted for interviews because investment from the US comprises the largest share of investment into Kazakhstan, and the second largest share of investment into Uzbekistan. For the years 1993-1998, investment from the US comprised the highest percentage of FDI into Kazakhstan at 32.9%. The country with the second highest percent of investment was Japan at 18.3% (*Kratkii statisticheskii ezhegodnik Kazakhstana* 1998, p. 117). Investment from the US also comprised the highest percent in the years 1999-2001 at 39.9% (IMF, 2003, p. 103). Comparable information on US investment into Uzbekistan is not as easily available. The Bureau of Economic Analysis does compile information on US capital outflows for direct investment abroad. However, data are suppressed if they would reveal financial information about a country.³⁵ Therefore, data on US investment into Uzbekistan was determined using two sources. First, the BISNIS web site reported that in 1998 and 2001, that Turkey and the US “were the largest investors.”³⁶ Second, the cumulative direct investment position of US firms for 1999 was \$167 US million.³⁷ Cumulative direct foreign investment in Uzbekistan for the years 1994-1999 was \$567 US million (EBRD Transition Report 2001, p. 68). The percent of US direct investment into Uzbekistan was about 28% for the years 1994-1999. Therefore, the US appears to be a significant investor in Uzbekistan.

³⁵ The suppressed items are denoted as “D” and the explanation is listed on the web site (www.bea.gov). Basically, suppressed data are used if a small number of companies are responsible for most of the data for that particular item.

³⁶ This data can be found at www.bisnis.doc.gov/bisnis/country/984uztr.htm and www.bisnis.doc.gov/bisnis/country/uzchapter2.htm.

³⁷ Data were suppressed for the years 1994-1998, see Table 11_9902 US Direct Investment Position Abroad on a Historical-Cost Basis: 1999-2002 Country Detail (www.bisnis.doc.gov/bisnis/country/uzchapter2.htm)

Firms such as the French oil company Total, the Italian firm Agip/Eni and the Russian firm Lukoil that have invested in Kazakhstan were not contacted because they had no US divisions or subsidiaries. Foreign firms may have different views on how economic reforms are related to their investment decisions, therefore their answers would have been a notable addition to the project. However, their absence is not likely to bias the results of the interviews since the largest percentage share of foreign investment into the case study countries is from US firms.

Developing the Questionnaire

The questionnaire³⁸ was developed primarily based on two sources of information. First, questions were formulated using information provided from interviews with IMF and World Bank economists concerning the areas of reform that each country differed. The most important difference between the two countries' reform efforts that was repeatedly mentioned was the issue of currency convertibility. The second source of information was a chapter by Jonathan Stern on important economic and political issues that western corporations would consider in their foreign investment decisions into Russia and the CIS.³⁹

In the beginning of the chapter, Stern outlined variables that comprise a "short-list of the most important issues" from western corporate investors. These variables included issues such as

³⁸ The three types of questionnaires are in Appendix A.

³⁹ Stern's chapter is from Dyker (1995). It should also be noted that the book was the result of papers developed for the Post-Soviet Business Forum. Investment firms were listed as providing support for the Forum.

Central/regional/local political relationships
Political stability at national, regional and local levels
Implementation and stability of legal and fiscal frameworks
Low domestic prices and non payment problems, combined with non-convertibility of currencies. (Stern, 1995, p. 59)

These issues were also incorporated into questions used in the questionnaire.

There were three different interview questionnaires used, based on whether the firm had conducted business or invested in Kazakhstan, or Uzbekistan, or in both countries. The questions remained similar, with the questionnaire for firms that had invested or conducted business in both countries resulting in a longer questionnaire. Additionally, if the firm had invested in one or both countries for natural resources, a question was asked as to whether the value of the natural resource did override an analysis of areas of economic reform in the country. There was also a separate questionnaire⁴⁰ provided at the end of the interview in which investors were asked to rank four indicators of economic reform based on the importance of each in the investment/business decision of the firm. The four indicators comprise the dependent variable of economic reform.

Conducting the Interviews

If a firm had an office in the Washington area, that office was first contacted for an interview with a representative. Two methods were used to determine whether there was a representative in that office who would be able to participate in the interview. First, I asked to speak with someone who could

⁴⁰ This sheet is also in Appendix A.

discuss the firm's business or investment in the appropriate country. This approach was successful, if the representative was in the Washington office. If an appropriate representative was not in the Washington office, reception would often suggest calling the corporate office. The second method was used if a name at the corporate office was not provided. The call to the corporate office would then begin with a request to speak to someone in investor relations. This proved to be the most effective in eventually being able to speak with the right person, as well as avoiding persons in Press and Communications departments, none of which were interviewed.

The conversation with the representative began with a statement of my name, and my position as a Visiting Scholar at the American Political Science Association, in Washington, D.C.⁴¹ Then, I briefly stated my dissertation research, and why I was requesting an interview. The most difficult part of securing the interview was convincing the representative that my request for an interview was for research and academic purposes.⁴² Almost all the interviewees requested that I send an e-mail explaining my project, and the disclosure form as an attachment. There was a great deal of concern about the types of questions that I would ask, and some representatives requested that a sample of questions be sent as an attachment as well.

⁴¹ Aberbach and Rockman (2002) and Dexter (1970) stated that it is often helpful to have a name of a research institute when trying to secure elite interviews. It is not likely that many representatives had heard of the APSA, but I was asked more than a few times "who are you with?"

⁴² See, for example, Johnson and Joslyn (1995) p. 263 on elites' request for further information on the research or researcher.

After the first few interviews were given only on the condition that the firm's name would not be used, it became clear that the firms would have to be re-classified by sector of investment or business. The interview questionnaire was used during the interviews, and notes were taken on the responses. Interviews were not recorded, it is likely that taping the interviews would not have been allowed, and the question was not asked. The notes and responses were typed soon after the interview to clarify important points made, as well as other information offered freely from the interviewees.

The interviews with investor and business representatives comprise an important part of the project in establishing a relationship between economic reform and investment. However, the results from the interviews are limited. First, there were only a limited number of firms that met the criteria for the study; investment or business in Kazakhstan and/or Uzbekistan. Second, a few of the interviewees seemed more knowledgeable concerning the investment or business decisions of their firms than other interviewees. Therefore, the information from some of the interviewees is less likely to be more accurate about investment and business decisions.

Conclusion

The comparative case study and elite interview methods are used for this project because they are believed to provide the most comprehensive understanding of the process of economic reform, and of the relationship between economic reform and investment/business in Kazakhstan and

Uzbekistan. The analysis offered in the next three chapters will examine these two areas in more detail. The following two chapters (five and six) on the case study countries will test the hypotheses and indicate how the independent variables have influenced economic reform.

Chapter seven will then comprise an analysis of the results of the investor/business interviews. The results from the interviews will produce evidence about the areas of economic reform that had the most influence on investment/business decisions. Then, the chapter will compare each country's progress on these specific economic reform areas.

Chapter 5: The Influence of the Soviet Era

As indicated in Chapter 1, the goal of this project is to develop a framework to understand the economic reform processes of Kazakhstan and Uzbekistan. This chapter will first briefly describe important cultural and societal factors that have influenced Soviet era and post-Soviet era development of these two countries. The chapter will then describe how the levels of integration under the Soviet era, including the degree and type of integration with Russia, have influenced differences in the international economic orientation of the two countries.

The Early Kazakhs

Unions of clans and tribes of Turkish and Mongol decent are the likely ancestors of the Kazakh people.⁴³ The history of the Kazakh's revolves around the fact that they were mainly a nomadic people. Martin (2001) emphasized the importance of the nomadic culture through her analysis of judicial customs based on a nomadic way of life. Nazarbayev (2001) also stressed the nomadic culture of the Kazakhs, and their connection with nature as an important part of the development of the Kazakh people (pp. 40-41). Olcott (1995) further emphasized the nomadic nature of the Kazakhs by explaining that the likely

⁴³ Olcott (1995) and Winner (1958) explained that it was difficult to determine the exact origin of the Kazakh people, before the conquest by the Russians and that most information comes from eighteenth century Russian emissaries and other officials.

development of the three hordes, were formed due to the three geographic regions based on pasturage routes.⁴⁴

The early Kazakh economy was centered on livestock breeding, and the necessity of the following the annual migration pattern from summer to winter grazing lands.⁴⁵ Therefore, it was important to have access to grazing lands for the herds, through planned migration patterns. This type of an economy then, did not place a value on land as private property; more important was the value of the herd and in the access to pasturelands for grazing (Olcott, 1995).⁴⁶

Early Russian attempts to settle these nomadic peoples, in as early as 1820, were not successful and had hardened the attitude of the Kazakhs toward the Russians (Olcott, 1995, pp. 57-65). The events from WWI and the Russian Civil War would lead to additional hardships for the Kazakh nomads. Olcott (1995) explained that the Civil War, and the famine afterward (in 1920) produced a substantial decline in agriculture and herd sizes, and had severely altered the pastoral nomadic patterns of the Kazakhs (pp. 158-159). She additionally stated rather bluntly that, "(t)he new authorities did not debate the issue of the settlement of Kazakh nomads, since (these) events had made pastoral nomadism no longer viable" (p. 161). By 1929, higher numbers of Kazakhs were

⁴⁴ Olcott (1995) detailed the differences between the zhuz and the horde, noting that the term zhuz horde does imply a common ancestry, whereby the term horde does not, and that hordes were likely formed for military and political purposes (see pp. 10-11). Chadwick and Zhirmunsky (1969) found that the tribes were divided into three hordes by the *khan* of the tribes for purposes of administration (pp. 5-6).

⁴⁵ In an interview with a World Bank economist, the economist stated that he believed that the nomadic, traveling culture of the Kazakhs had contributed to their acceptance of outside ideas and influences, and had influenced their progress on economic reforms (Interview, World Bank economist, July 12, 2002).

⁴⁶ Winner (1958) emphasized the importance of the herd by citing the fear of the Kazakhs of the freezing over of previously thawed snow (*džut*); which would prevent the cattle from having access to fodder (p. 3-5).

involved in agriculture (over 30% of farmers in Kazakhstan), even though recovery in this sector was slow (Olcott, 1995, p. 173).

Gleason (1997) stated that Kazakhstan's economic development as a republic was based on two programs. One program was the continued emphasis on agriculture, as seen in the Virgin Lands campaign of the 1950's. The second program was the establishment of Soviet industrial and research facilities on the Kazakh northern border with Russia. The affects of these programs on Kazakhstan's development and integration with Russia will be explored further in subsequent sections.

The Early Uzbeks

The Uzbeks are descendants from nomadic Turkic tribes, and the name Uzbek was likely used as a tribal classification (Critchlow 1991, p. 3).⁴⁷ The Uzbeks have been very interested in tracing their complex cultural heritage, a practice that occurred before and during the Soviet era, and continues in current times. One event in particular that impacted future society was the invasion of the Arabs in the late seventh century, and the subsequent introduction of Islam to the modern day city of Khiva (Critchlow, 1991, p. 4-5). By the eighth century Islam would play a fundamental role in the region, with Bukara as the birthplace

⁴⁷ Chadwick and Zhirmunsky (1969) noted that the Uzbeks would have likely been descendant from the eastern Turks, which comprised the people of Turkestan and Central Asia; also see Czaplicka (1918) for a detailed analysis of the classification of the Turks, and the Turks of the Central Asian region.

of Sufi Islam, and the Fergana Valley as the location of important Islamic shrines and madrasas (Lubin 1999, pp. 39-40).⁴⁸

Early Uzbek leaders would also continue to be glorified, including Amir Timur (Tamerlane), who ruled from Samarkand during the fourteenth century; and one of his descendants Babur. Allworth (1990) found that the glorification of Timur was happening as early as 1919, with modern Central Asians in Bukhara calling on the brothers and “famed sons of Timur” to organize (p. 174). Critchlow (1991a) additionally pointed out that Timur and Babur were celebrated in recent Uzbek historical novels. Melvin (2000) explained that the re-making of Timur into a conqueror and nation builder served to promote Uzbek national pride as the “dominant political and cultural force in Central Asia” (p. 46).⁴⁹ This continued glorification of leaders in the past would be revisited with the rehabilitation of Sharaf Rashidov and other Uzbek nationals in the cotton affair.

Integration Levels During the Soviet Era

The differences in the levels of integration of Kazakhstan and Uzbekistan during the Soviet era are believed to have influenced the degree of international economic orientation of the regime. Kazakhstan’s higher level of integration with the Soviet Union (Russia) is hypothesized to have resulted in more international economic orientation. Conversely, Uzbekistan’s lower level of integration with the Soviet Union (Russia) is hypothesized to have resulted in less international

⁴⁸ See also Allworth (1990) for an extensive cultural history of the Uzbeks.

⁴⁹ Uzbekistan also declared the year 1997 to be the “Year of Timur” (Kirimli, 1997, p. 54).

economic orientation. These integration levels will be analyzed in three areas: geographic, political and economic.

Geographic

The most obvious area of geographical difference in orientation is the fact that Kazakhstan borders Russia, while Uzbekistan is located further south (see Map 1).⁵⁰ This section will review the areas in which Kazakhstan's infrastructure was necessarily integrated with Russia's, and how Uzbekistan's infrastructure was not as integrated. These differences would affect each country's ability to function independently from Russia in the post-Soviet era.

Kazakhstan's proximity to Moscow, and thereby the shorter distance to the center, likely explains one difference in investment allocation and other areas in which Kazakhstan was treated more favorably than the other republics. Brukoff (1995) for example, stated that Kazakhstan received funding levels higher than the union average, and that this resulted in industrial development in areas such as metallurgy, machine building and heavy and light industry. The republic was also a focus of Russia during the Virgin Lands campaign, which began in the early 1950's. During this campaign, large numbers of Russians immigrated to the northern region of the republic in order to cultivate previously barren land for increased grain production.

The location of the Soviet space center in Baykonur, Kazakhstan as well the coal processing facilities in Karaganda would also necessitate a higher

⁵⁰ All of the maps appear in Appendix B. Gleason (2001b) points out that Kazakhstan and Russia have the longest continuous border between two countries in the world (p. 1083).

degree of integration with Russia.⁵¹ Olcott (1997) stated that Kazakhstan's, "...boundaries were never intended to be those of an independent state" (p. 201). While this statement is true of all of the former republics, Kazakhstan's position is unique. Rumer (1996) pointed out that Kazakhstan's industrial production, as well as communication, electrical power and pipelines were all linked with Russia's sectors (p. 35). These linkages were part of the reason for the decline of the production of primary resources such as coal, electricity and crude oil from their Soviet era levels in Kazakhstan. The following section will discuss the integration of the electrical, coal and pipeline systems in more detail.

Kazakhstan's electrical power and coal systems were divided mainly into two grids: the north and the west that was connected to the Russian system and the south connected to the rest of Central Asia (see Map 2).⁵² Many of the largest electrical generating stations were located in Russia, near Moscow. There were also minor thermal stations in west Kazakhstan at Gur'yev, and Aktyubinsk, and north Kazakhstan at Ural'sk (see Map 2). Later plans aimed at increasing production would involve a major hydroelectric station in Kazakhstan at Ust-Kamenogorsk, completed in 1953, with an estimated output of 500,000 kw (Economist Intelligence Unit 1963, p. 53).

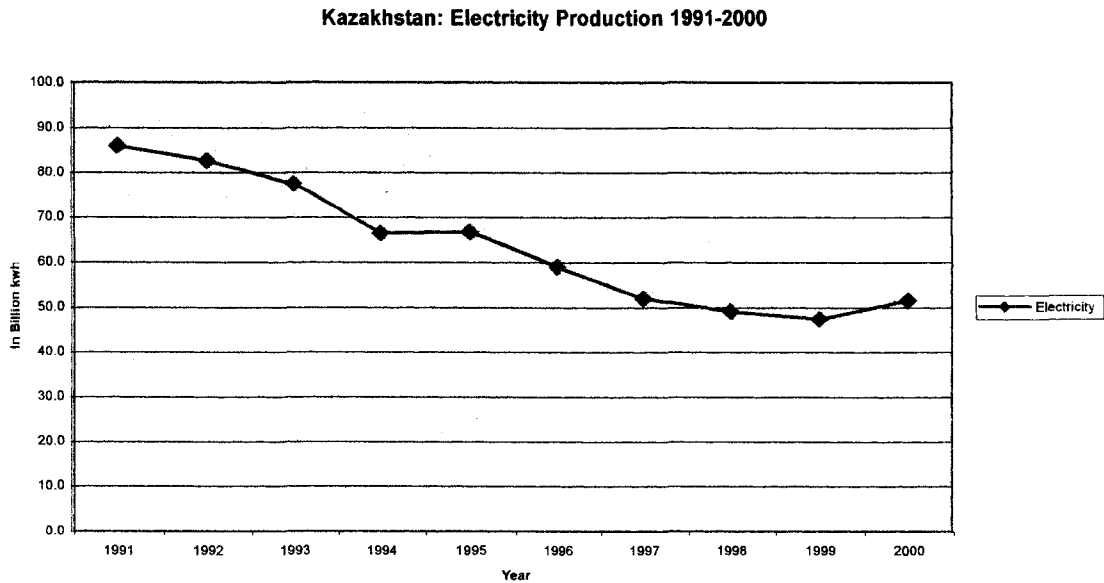
Kazakhstan did not have a unified electrical supply system during the Soviet era (Cummings, 2000, p. 23). Therefore, one factor for decreases in electrical production in Kazakhstan resulted from interruptions in the electrical

⁵¹ See Gleason (1997) p. 52, for more on the importance these facilities for Kazakhstan's economic development. The coal processing facilities in Karaganda, specifically in the Maykuben basin has a current output of 4 million tones per year and supplies the AES facilities in the area (AES Background Information, October 2003).

⁵² Located in Appendix B.

grids.⁵³ Figure 5.1 charts the decreases in electrical power in Kazakhstan from the end of the Soviet era until the year 2000.

Figure 5.1 Kazakhstan's Electricity Production, 1991-2000⁵⁴



Production declines would also result from a drop in demand, declines in output from the initial stages of economic reform, and increases in energy prices (World Bank, 1993a, p. 112-113). Kazakhstan's production of electricity had the sharpest drop in 1994, to 66 billion kwh, and continued to decline to 47.5 billion kwh in 1999. The average price for electricity paid by all customers also

⁵³ After independence, Moscow would cut off power to Kazakhstan's northern factories for unpaid debts due by Kazakhstan to Russia (Olcott, 1998, p. 100).

⁵⁴ Data from IMF, 1998a, p. 31; CIS Statistical Yearbook, 2002, p. 50.

increased from 90 tenge (per 1000 kwh) in January of 1994 to 1,260 tenge in January 1995 (IMF, 1999, p.104).

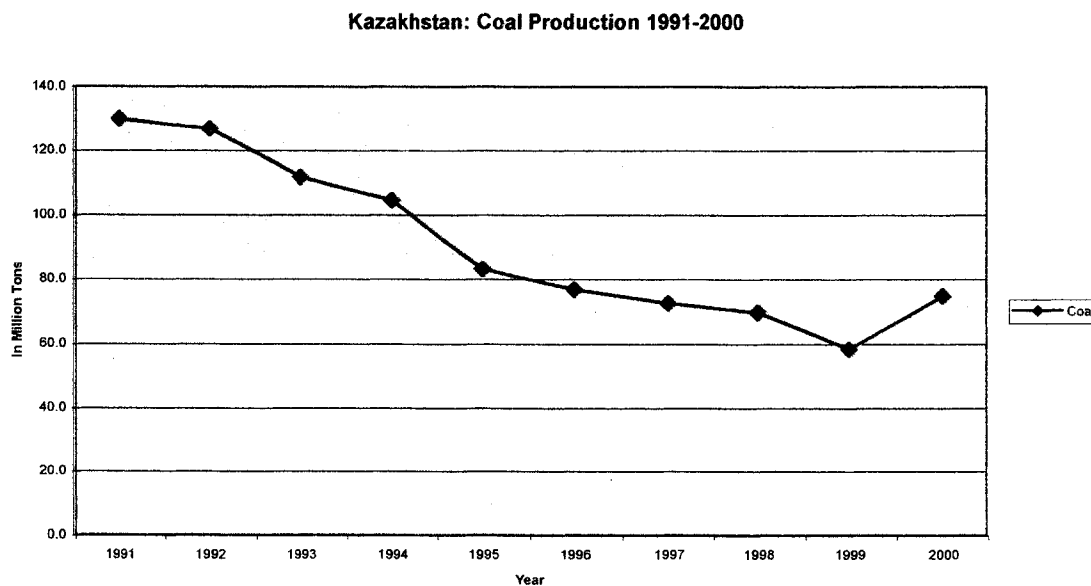
Kazakhstan was the third largest coal producer in the Soviet Union, and about 40% of its production was exported mainly to Russia (World Bank, 1993a, p. 111). There were two large coal reserve fields located in Russia, the Donbass field west of Saratov, and the Kuzbass, just east of Barnaul and Tomsk (see Map 2). The other prominent field was the Karaganda field located in Kazakhstan (see Map 2). This field would become more important for the Soviet Union, because it would be the main supplier of coking coal for the metallurgical industries of the Urals.⁵⁵ In order to facilitate transportation of coal from the Karaganda field to Urals, a multiple track railway line was built during the 1930's. The new construction of railways was deemed important for "intraregional transport connections", and the construction of the rail line in order to transport the coal to Russia was another indicator of the importance of the Karaganda field as a supplier for Russian industry.⁵⁶

Kazakh coal production also decreased after the end of the Soviet Union. Production dropped 55% from a high of 130 million tons in 1991 to only 58 million tons in 1999 (see Figure 5.2).

⁵⁵ In 1960, the Kuznetsk and Karaganda coal basins were stated as being able to produce enough coking coal to supply the metallurgy needs of the Urals for "many years" (*Planovoye khozyaistvo*, No. 2, February, pp. 11-22; in Current Digest of the Soviet Press (CDSP), Vol. XII, No. 15, p. 5).

⁵⁶ *Voprosy ekonomiki*, No. 2, February, pp. 25-35; in CDSP, Vol. XII, No. 11, p. 12).

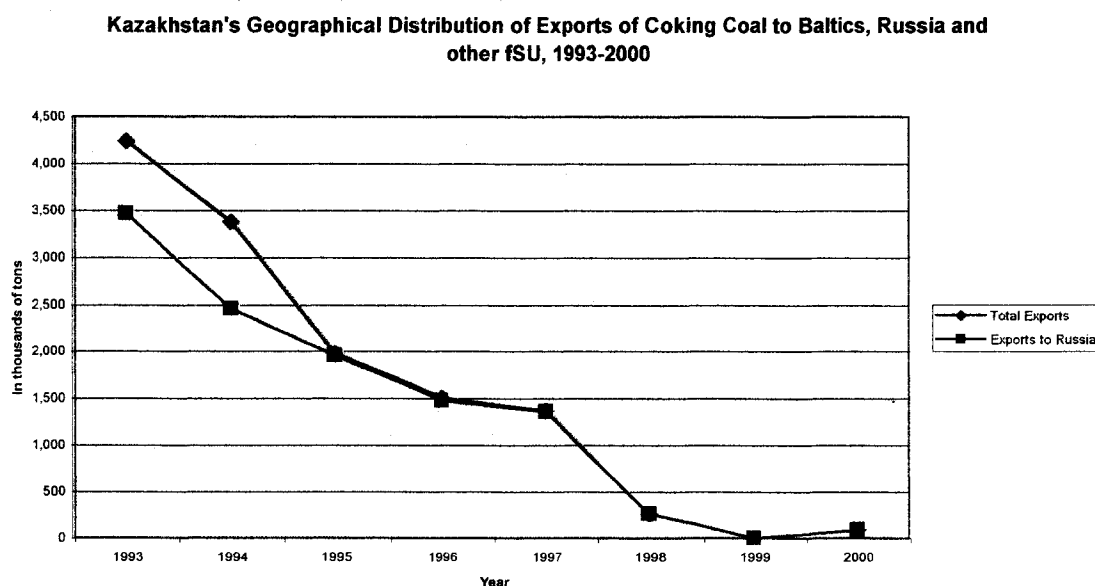
Figure 5.2 Kazakhstan's Coal Production, 1991-2000⁵⁷



The drop in coal production was due to the restructuring of the sector, high tariffs for the use of Russian rail systems and price increases resulting in decreased demand (World Bank, 1993a, p. 107; IMF, 1996a, pp. 6-7). Kazakhstan's production of coking coal also declined steadily after independence. However, almost all of its production of coking coal exported to its traditional trading partners was still exported to Russia (see Figure 5.3).

⁵⁷ Data from IMF, 1998a, p. 31; Commonwealth of Independent States (CIS) Statistical Yearbook, 2002, p. 51.

Figure 5.3 Kazakhstan's Export of Coking Coal to Baltics, Russia and other fSU, 1993-2000⁵⁸



The reasons for the continued exports of coking coal to Russia may have also been the result of rail tariffs, and the lack of ability of other republics to pay for coking coal, but it is a stark example of one area of integration of these two republics resulting from the Soviet era.

Kazakhstan also did not have a unified oil and gas pipeline system during the Soviet era. The two main refineries are Pavlodar in the northeast part of the

⁵⁸ Data from IMF, 1996, p. 102; IMF, 1999, p. 127; IMF, 2002, p. 95.

country, and Shymkent in the southeast, while the main oil deposits are in west Kazakhstan (see Map 3).⁵⁹ Kazakhstan's oil was exported to Russia for refining, while Kazakhstan's refineries were designed to refine crude from Siberia via the Omsk- Pavlodar–Shymkent pipeline (World Bank, 1993a, p. 8). The primary oil pipeline for Kazakh's crude was from Shevchenko – Orsk (see Map 3).

Kazakhstan does have sizable reserves of crude oil, but the problem was the country's lack of a connected pipeline and refinery systems to refine and export the oil.

Early estimates of Kazakhstan's recoverable oil reserves were at 12 billion barrels, and the country ranked second in oil production after Russia (of the fSU countries) (World Bank, 1993a, p. 8). More recent estimates put Kazakhstan's proven and probable recoverable reserves much higher at 30 billion barrels (IMF, 2003, p. 5). However, as previously stated, the Soviet system was not designed to operate around republic boundaries, and Kazakhstan's production of crude oil fell from 26.6 million tons in 1991, and continued to decline to 20.6 million tons in 1995. Production did not increase significantly to 35 million tons until 2000 (CIS Statistical Yearbook, 2002, p. 50; IMF, 1998a, p. 31). Refinery operations also declined due to the decline of crude oil delivered from Russia, and to the lack of refineries able to refine Kazakh crude oil (IMF, 1995, pp. 6-8). One reason for Russia's higher degree of integration with Kazakhstan was certainly to be able to take advantage of, and have control over the country's natural resources. The

⁵⁹ Located in Appendix B. There was a small refinery in Atyrau, but it could only process a limited amount of oil (Alexandrov, 1999, p. 261).

fact that Kazakhstan borders Russia made it much easier for the two republics to be more integrated.

Uzbekistan is located much further from Russia, and while the country is also endowed with natural resources the types of resources as well as its structural connectivity to Russia was different. This section will first review Uzbekistan's potential in the petroleum sector. Then the importance of Uzbekistan's endowment of gold, and its internal system of natural gas lines will be analyzed.

Uzbekistan's oil reserves were estimated at 244 million tons in 1993, with "a vast territory" that had not been explored (World Bank, 1993b, p. 141). While the potential in this sector was not equal to that of Kazakhstan or Russia, the early assessment by the economists was that

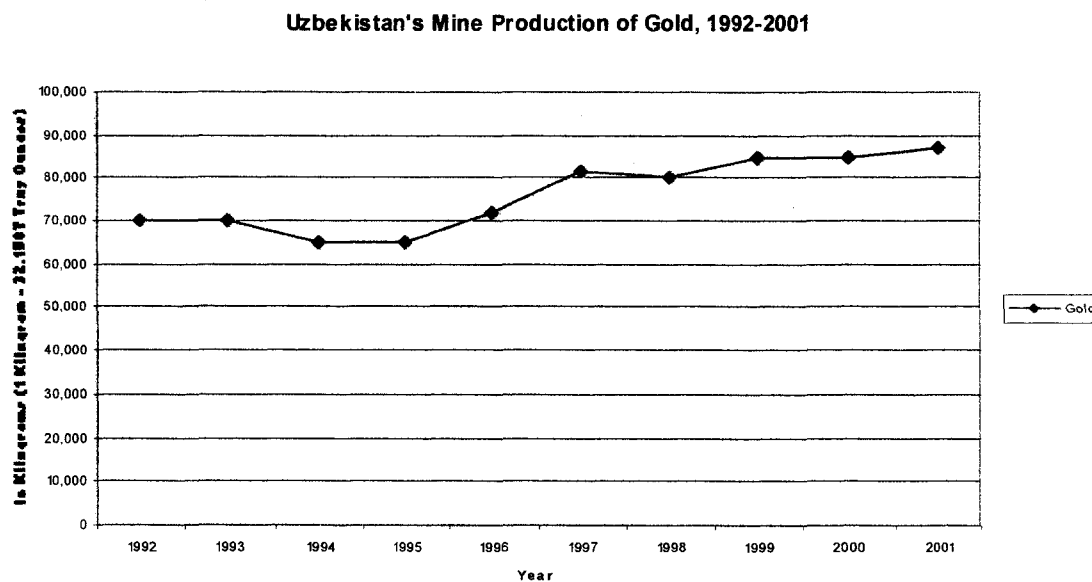
If sufficient investment is attracted, Uzbekistan could be expected to expand its oil production capacity, to become oil self-sufficient in the next few years, and to become a net exporter of oil in the long term. (World Bank, 1993b, p. 141)

However, outside investment including importing equipment and Western technology would be necessary in order to increase oil production. Therefore, the investment framework that was recommended for Uzbekistan included the implementation of petroleum legislation and taxation in order to attract this type of investment (World Bank, 1993b, p. 137).

Uzbekistan was already a substantial producer of gold and natural gas for the Soviet Union, during the Soviet era. The country's gold production was 1/3 of the production of the entire fSU (World Bank, 1993b, p. 4-5). Gold and oil are

both natural resource commodities, but an important difference between the two commodities is that a country's ability to export gold does not depend on a transportation system (pipelines) in order to transport the resource to the market. Further investment would also be needed to increase the gold mine potential in Uzbekistan from its Soviet era production levels, but mining operations during the Soviet era were already such that the country would be the eighth largest producer of gold in the world after independence.⁶⁰ Gold production in Uzbekistan showed a slight drop off in 1994-1995, from levels seen in 1992-1993. However, production increased markedly from 1997, through estimates for 2001 (see Figure 5.4) (The CRB Commodity Yearbook, 2003, p. 111).

Figure 5.4 Uzbekistan's Mine Production of Gold, 1992-2001⁶¹



⁶⁰ CRB Commodity Yearbook 2000, p. 111. Thirty gold mines have been identified in Uzbekistan, but only ten are currently being mined (IMF 1996b, p. 9; Khudaiberganov, 1998, p. 190).

⁶¹ Data from CRB Commodity Yearbook 2003, p. 111. Data for 2000 is preliminary; data for 2001 is an estimate.

Uzbekistan's ability to export gold would provide an important source of revenue for the government.

Uzbekistan was the third largest producer of natural gas in the fSU (behind Russia and Turkmenistan) (World Bank, 1993a, p. 4-5). However, most of the production of gas was consumed domestically for local industry, and only about 8 percent was exported to Russia primarily through the Bukhara pipeline to the Urals (World Bank, 1993b, p. 4). Uzbekistan had its own internal gas lines, as well as other larger gas fields (see Map 4).⁶² Zettlemeier (1998) and Alam and Banerji (2000) have discussed Uzbekistan's self sufficiency in energy as one reason for the country's slow decline in output relative to the other fSU.

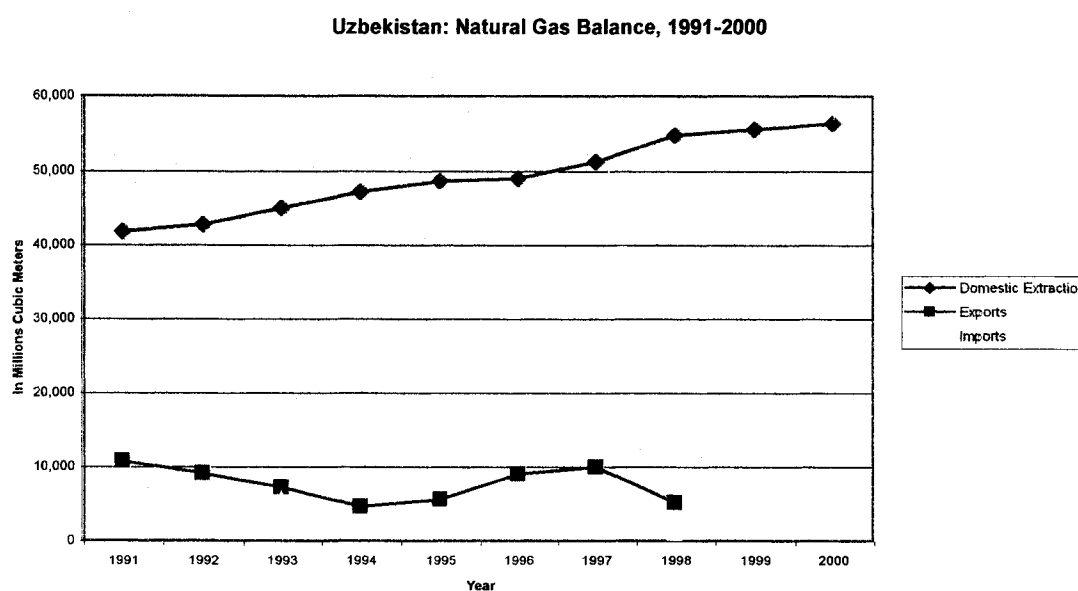
Uzbekistan's large endowment of natural gas, and its primary use for local industry purposes during the Soviet era allowed the country to have more control over this resource after the end of the Soviet Union.

Uzbekistan has additionally been able to increase domestic production of natural gas from 1991-2000, and has generally been able to decrease its imports of natural gas from a high of about 7 million cubic meters in 1991, to a low of about 1 million cubic meters in 1998 (see Figure 5.5).⁶³ The increases in domestic extraction and relatively low increases of exports indicate that natural gas is predominately used for domestic purposes.

⁶² Located in Appendix B.

⁶³ It should also be noted that the Uzbekistan economy operates like a planned economy, and as such, the government has considerable control over decisions about amounts of products for import and export.

Figure 5.5 Uzbekistan's Natural Gas Balance, 1991-2000⁶⁴



Uzbekistan was in a unique position after the end of the Soviet era, in that it was able to benefit from its previous position as a supplier of raw materials such as gold and cotton. At independence, the country was then able to

...divert these more marketable exports to western markets and avoid the disruptions in trade patterns that other republics experienced. (IMF, 1997b, p. 5)

Uzbekistan's position as supplier of cotton will be reviewed in the next section.

⁶⁴ Data were not available for exports and imports of natural gas after 1998. Data from IMF, 1996b, p. 91; IMF, 2000, p. 52; CIS Statistical Yearbook, 2002, p. 51.

These differences in the structures of the Kazakh and Uzbek economies, largely due to resources and geography, have shaped each country's international economic orientation based whether the country was more or less integrated with Russia during the Soviet era. While time series data are not readily available about each republics trade with Russia during the Soviet era, data from two years provides information indicating that Uzbekistan's economy may have been less dependent on interrepublican trade than Kazakhstan's economy during the Soviet era.⁶⁵ Data from 1987 on interrepublic trade show that Uzbekistan had a positive terms of trade balance at (+130) (millions of hard currency rubles) while Kazakhstan had a much larger negative terms of trade balance at (-1068) (millions of hard currency rubles).⁶⁶ Table 5.1 also shows that while both republics imported more products than they exported through interrepublic trade, Kazakhstan had a much higher negative trade balance than Uzbekistan.

Table 5.1 Interrepublic Import and Export of Products for 1988 (in millions of rubles)

Republic	Imports	Exports	Export (+) or Import (-) Balance
Uzbek SSR, Total for Material Production Sectors	12,327.1	10,486.9	-1,840.2
Kazakh SSR, Total for Material Production Sectors	16,420.1	9,164.8	-7,255.3

Source: JPRS-UAE-90-022, July 24, 1990, p. 50

⁶⁵ Brukoff (1995) also found that Kazakhstan was dependent on interrepublic trade (p. 36).

⁶⁶ Data from *Ekonomika i zhizn'*, no. 10, March 1990, p. 7.

Kazakhstan was more geographically integrated with Russia, and would need more international involvement for the country to be able to function independently of Russia. Uzbekistan was not as geographically connected to Russia, and substantial international involvement would not be as necessary for the economy to function. The following section will look at issues of political and economic integration. The section will expand upon Kazakhstan's established integration with Russia in the areas previously discussed, and Uzbekistan's agricultural sector will be examined.

Political and Economic

These two levels of integration will be examined together because it would be difficult to examine them separately. Decisions made during the Soviet era were based on political and economic considerations. One reason for the higher political integration of the Kazakh republic during the Soviet era was due to the reliance of the center on the republic's resources, outlined in the previous section. Kazakhstan's relationship with Russia vis-à-vis the other republics was also stronger due to the republic's minority of Kazakhs, and plurality of Russians for most of the republic's history. This was not an accidental occurrence, and large numbers of Russians were purposefully settled in the Kazakh region in three specific time periods: in the 1920's and 1930's under Stalin's collectivization drive, during the Virgin Lands campaign of the 1950's under Khrushchev, and during the industrialization process in the 1960's and 1970's

(Olcott, 1996, p. 60). The goal of the Virgin Lands campaign was to increase the Soviet Union's self-sufficiency in the production of food, by increasing land cultivation primarily in the Kazakh steppe and in southern Siberia (Olcott, 1995, p. 225-227). The campaign was concentrated in north Kazakhstan, and these areas would receive a large inflow of Russians (Gilbert, 2002, p. 136). The result was that for most of Kazakhstan's history, the Kazakhs were a minority in their own country, and the Russians a plurality. This demographic situation did not occur in any of the other Soviet republics.

In 1926 Kazakhs comprised 59.5% of Kazakhstan and Russians 18%; in 1939, Kazakhs only comprised 38%, and Russians 40.2% (Alexandrov 1999, p. 310). Kazakhs would not comprise a majority in Kazakhstan until 1989, and even then it was a small majority compared with Uzbekistan (see Table 5.2).

Table 5.2 Comparison of Titular and Russian ethnic groups for 1989 in Kazakhstan and Uzbekistan

Country	Titular Ethnic Group %	Russian %
Kazakhstan	40	38
Uzbekistan	71	8

Data from CIA 1995, Comparative Ethnic Groups in the Former Soviet Union in 1989.

The demographics of higher percentage of Russians than Kazakhs would necessitate that Kazakhstan have a higher degree of integration with Russians than Uzbekistan. One example of this is the high percentage of Kazakhs who know the Russian language. In 2001, 75 percent of Kazakhs knew Russian,

versus 35 percent of Uzbeks that knew Russian in 2000 (Statistical Yearbook of Kazakhstan, 2002, p. 443; Kudat, Peabody, and Keyder, 2000, p. 221).

While the agricultural sector would still be an important sector in Kazakhstan, it would not have the continuing effects on the republic that would be seen in Uzbekistan. The main reason for this is that while the Virgin Lands campaign may have had some success, by and large it was considered unsuccessful and discontinued in the 1970's (Gilbert, 2002, p. 136). Development of the integration of the industrial sectors of northern Kazakhstan and the Urals region however, would be viewed as important to the integration of the two republics in their economic and geographical relationship.⁶⁷ The contributions of the Uzbek republic during the Soviet era would be concentrated in the agricultural sector.

Uzbekistan's total area for agriculture would increase substantially more than any other republic involved in the agricultural sector. The republics' agricultural area would increase from 19.2 million hectares in 1949, to 26.6 million hectares in 1958 (Committee for World Atlas of Agriculture, 1969, p. 488).⁶⁸ While Uzbekistan is primarily identified for its cotton growing, the country was also an important producer of fruits and vegetables. During the Soviet era, the republic was the largest producer of fruits and vegetables within the Soviet Union (World Bank, 1993b, p. 5). Table 5.3 shows the increases in the

⁶⁷ Specifically mentioned was the formation of "an interrepublic economic-geographical region" between the Kostanai industrial region and the southern Urals industrial complex (*Voprosy ekonomiki*, No. 2, February 1960, pp.25-35; in CDSP, vol. XII, No. 11, p. 12).

⁶⁸ Republics and satellite countries include Russia, Ukraine, Moldova, Kazakhstan, Turkmenistan, Tajikistan, Kyrgyzstan, Georgia, Armenia and Azerbaijan.

production of fruits and berries in Uzbekistan from 1960 –1970, for the six highest producing oblasts.

Table 5.3 Production of Fruits and Berries for the Six Highest Producing Oblasts in Uzbekistan 1960-1970

	1960	1965	1969	1970
Oblast	(in thousands of tons)			
Tashkent	185.8	666.2	370.9	1365.9
Fergana	223.6	296.9	177.2	441.0
Namagan	238.0	304.9	141.6	397.8
Andizhan	173.9	274.9	218.1	364.8
Samarkand	70.3	182.9	78.0	531.4
Surkhandarya	22.6	104.1	88.2	251.5

Data from: *Uzbekistan za gody vos'moi piatileki (1966-1970gg)*, 1971, various pages.

The total production of fruits and berries for the six highest producing oblasts of Uzbekistan in 1970 was a little over 3 million tons (3,352,000). The most recent comparable data available after 1970 indicate that the production of fruits and berries in Uzbekistan fell to only 660 thousand tons in 1986 (World Bank, 1993b, p. 285). Uzbekistan's production of fruits and berries would not increase substantially again until 2000 and 2001 at 791 and 801 thousand tons, respectively (CIS Statistical Yearbook, 2002, p. 63). The production of these agricultural crops, which were traditional to Central Asia, was decreased due to the focus on increases in cotton production (Rumer, 1989, p. 71).

The tsarist regime became interested in Central Asia's ability to be able to grow cotton when the cotton industry was cut off from US exports during the US Civil War during the 1860's (Olcott, 1995, p. 71; Fierman, 1991, p. 13). During the Soviet era, substantial decreases in cotton imports did not occur until the mid 1930's, when imports were reduced to about 50,000 tons from 100,000 tons in 1929 (Economist Intelligence Unit 1963, p. 48). This was achieved by increasing the area of cotton grown in the Soviet Union from only 688 thousand hectares in 1913 to 2,024 million hectares between 1934-38 (Economist Intelligence Unit, 1963, p. 48). Irrigation systems were developed during the 1960's, and were used to harness the Amu-Darya and Syr-Darya rivers in order to increase the cotton growing areas of Uzbekistan and Turkmenistan. Table 5.4 shows the increases in production of raw cotton in the seven largest producing oblasts.

Table 5.4 Production of Raw Cotton in the Seven Highest Producing Oblasts in Uzbekistan 1960-1970

	1960	1965	1969	1970
Oblast	(in thousands of tons)			
Tashkent	249	353	317	380
Syrdarya	284	441	460	576
Fergana	323	465	453	495
Samarkand	311	382	365	443
Bukhara	218	314	402	469
Kashkadarya	144	194	272	302
Khorezm	265	352	330	407

Data from: *Uzbekistan za gody vos'moi piatileki (1966-1970gg)*, 1971, various pages.

The total production of raw cotton for the five highest producing oblasts of Uzbekistan in 1970 was a little over 3 million tons (3,072,000). The most recent comparable data available after 1970 indicate that the production of cotton⁶⁹ continued to increase, and by 1986 was at almost 5 million tons (4,989,000) (World Bank, 1993b, p. 285). Uzbekistan's production of raw cotton continued to increase to over 5 million tons for 1988-1990, falling slightly in 1991 to 4,647,000 million tons (World Bank, 1993b, p. 285).

A comparison of the differences in the production of two agricultural crops (fruits and berries, and cotton) is meant to show how the focus on the agricultural sector would be altered during the Soviet era in Uzbekistan. This is especially evident once the irrigation methods were used around the Amu-Darya and Syr-Darya rivers, so that more land could be irrigated for cotton growing.⁷⁰

While Uzbekistan is the primary producer of cotton, the country was not the primary location of the manufacture of cotton textiles. Only a very small amount of cotton production remained in Uzbekistan, (about 4 to 5 percent) the majority of production of cotton textiles was located in the European part of the Soviet Union (Rumer 1989, p. 72). The disparity between the location of cotton growing, and the location of primary cotton manufacturing is illustrated in Map

⁶⁹ Cotton production in the World Bank publication was listed as "Cotton" and "Cotton Fiber." Cotton fiber was not listed separately under the listing for all agricultural products, in the publication, *Uzbekistan za gody vos'moi piatileki (1966-1970gg)*, 1971. Therefore only the data for the production of raw cotton was used.

⁷⁰ The irrigation methods would also result in the desiccation of the Aral Sea. The surface area of the sea declined by 50 percent from 1960-1996 (Information provided in interview, World Bank economist, July 10, 2002).

5.⁷¹ There are some secondary cotton manufacturing oblasts in Uzbekistan (Fergana and Tashkent) but the primary cotton manufacturing oblasts (Ivanovo and Kostroma) are located near Moscow. Rumer explained that this decision by the Soviets was based on policies meant to regulate the development of certain regions, and was not based on any sound economic policies. He stated further that

Indeed, the shipment of cotton fiber over such immense distances is very costly and compounds the acute difficulties that already beset the creaking and overloaded railway system. If to that are added the costs of reshipping textiles back to Central Asia and Kazakhstan to clothe the population there, the entire Moscow argument proves specious. (Rumer, 1989, p. 73)

There was already a single-track railway built from Tashkent to Orenburg, during the tsarist regime, in order to facilitate the transport of cotton from the region to Moscow. Rumer further explained the logic by which Soviet planners operated, which explains much about Uzbekistan's development into a cotton monoculture. He stated that the purpose of an economic region was to

...raise the efficiency of the economy and provide for the multisided use of natural, human and technical sources of a region in the interests of increasing the general economic capacity of the country. (Rumer, 1989, p. 12)

This information is important in explaining three concepts about why Uzbekistan was viewed as an ideal republic for the purpose of cotton production during the Soviet era. These developments would also influence post-Soviet Uzbekistan.

First, Uzbekistan was seen as a primary agricultural producer because of its favorable climate and physical attributes. Successful cotton growing requires

⁷¹ Located in Appendix B.

sun during the growing and flowering season, a lack of severely cold weather and an abundant supply of water (Rumer, 1991, p. 62-63). Uzbekistan's climate had all of these conditions naturally, except for the adequate rainfall that is needed to grow cotton. Uzbekistan averages about fifteen inches of rainfall annually, but only averages about three inches during the cotton-growing season of mid-June to mid-August.⁷² Therefore, in order to facilitate the additional water needed for cotton growing, vast irrigation systems were developed around the natural waterways of the two largest rivers the Syrdar'ya and the Amu Darya, which fed into the Aral Sea.⁷³

Second, cotton production is extremely labor intensive.⁷⁴ Uzbekistan is the most populous of the Central Asian republics, and was the third most populous of the fSU republics (World Bank 1993b, p. xi). Uzbekistan would have a notable shift of a much higher percentage of its population in the rural areas, as cotton production increased. From 1959-1971, the number of persons in all oblasts of Uzbekistan living in the cities (urban population) grew from 2,759,000 to 4,483,000. The number of persons living in rural areas from 1959-1971, increased from 5,502,000 to 7,840,000 (*Uzbekistan za gody vos'moi piatileki (1966-1970gg)*, 1971, p. 6). The shift from the urban population to the rural

⁷² Rumer, 1991, p. 62-63.

⁷³ See Small and Bunce (2003) for a recent, excellent analysis of the desiccation of the Aral Sea and the environmental and social consequences of the effects from the irrigation techniques used during the Soviet era.

⁷⁴ Rumer (1989) stated that cotton was "one of the most labor-intensive of all agricultural crops" (p. 65).

population would be the most notable in the seven highest producing oblasts of cotton, for the years 1959 and 1971 (see Table 5.5).⁷⁵

Table 5.5 Urban and Rural population shifts for the Seven Highest Cotton Producing Oblasts in Uzbekistan 1960-1970

	Urban	Urban	Rural	Rural
	1959	1971	1959	1971
Oblast	(in thousands of persons)			
Tashkent	327	605	705	909
Syrdarya	114	179	413	579
Fergana	301	449	638	920
Samarkand	296	401	735	1113
Bukhara	130	299	444	663
Kashkadarya	67	137	441	695
Khorezm	64	106	317	467

Data from: *Uzbekistan za gody vos'moi piatileki (1966-1970gg)*, 1971, p. 6.

This trend would continue, and by 1985, the rural population would comprise 59 percent of the total population while the urban population would comprise 40 percent. By 1995, the rural population would comprise 62 percent of the total population while the urban population would only comprise 39 percent (World

⁷⁵ Only data for the years 1959, 1970 and 1971 were given for the demographic shifts in the population for the oblasts of Uzbekistan (*Uzbekistan za gody vos'moi piatileki (1966-1970gg)*, 1971, p. 6).

Bank, 1993b, p. 253). The population shift from the urban to the rural sector resulted from the need of additional labor to increase cotton production.

Third, the type of cotton that Uzbekistan would grow was also dictated by Soviet ideas that focused on increases in production. Uzbekistan primarily grew upland (short staple) cotton as opposed to pima (long staple) cotton during the Soviet era, and the country continues to grow primarily upland cotton (Interview, Official from the Embassy of Uzbekistan, October 9, 2003). The differences between the two types of cotton have to do with the length of the strain (long or short), which in turn determines the worth of the cotton; the longer the strain the more it is worth.⁷⁶ Therefore, pima cotton is used for higher quality, and higher priced, textiles, while upland cotton is used for lower quality, and lower priced, textiles. However, pima cotton has a longer growing season, which means that less cotton can be grown overall, versus upland cotton.⁷⁷ This is likely why upland cotton seeds were planted in Uzbekistan in order to increase the overall production of cotton.⁷⁸ The evolution of Uzbekistan's economy into a "cotton monoculture" would be based on some degree of specialization of production, as well as disastrous irrigation techniques. Kirimli (1997) in fact stated that

Irrigation policies and efforts to increase cotton production in Uzbekistan are one of the reasons that have led to present economic conditions in this newly independent republic. (p. 59)

⁷⁶ Background information on cotton was provided in an interview with an expert on cotton (Interview, September 25, 2003).

⁷⁷ Pima cotton also requires less water than upland cotton, which is ironic considering the irrigations techniques that were needed to facilitate cotton growing in Uzbekistan.

⁷⁸ Although a Soviet agronomist argued that the main reason that fine-fiber cotton was not primarily grown in Uzbekistan was due to "inertia"; he argued further that Soviet scientists had developed a way to produce high-yield varieties during the same length of growing season as lower-yield varieties (*Pravda*, Dec. 2, 1972, p. 2 (condensed text); in CDSP, Vol. XXIV, No. 48, p. 17).

Kazakhstan and Uzbekistan are similar in some respects of integration levels in that they both provided natural resources to Russia. Kazakhstan provided coal, electricity, and refining capabilities to refine oil from Russia. Russia used these natural resources in different ways and made more of an effort to integrate Kazakhstan's resources with its own. This was largely done for practical and administrative reasons, including building rail systems, and moving Russians to the northern part of the republic.

Uzbekistan's level of integration during the Soviet era was different in that there was not the same degree of effort to integrate Uzbekistan's resources. Uzbekistan remained a supplier of primary products, and efforts were not made to integrate these resources. Uzbekistan was a primary cotton grower, but not a primary textile manufacturer. Also, there were not efforts to re-settle large numbers of Russians in Uzbekistan, which would allow for stronger nationalistic feelings to increase in the republic. These differences in integration levels would become even more defined during the Brezhnev era.

The Brezhnev Era

The Brezhnev era (1964-1982) was a significant period for the Soviet Union. Sovietologists have often categorized Soviet politics by studying different eras because they are "...periods associated with specific leaders doing specific things" (Bunce and Echols, 1980, p. 1). Brezhnev as the First Secretary of the CPSU acted to alter the relationship between the center and the republics, which

had operated under Khrushchev. Kelley (1987) explained that Brezhnev's political strategy would be different because

Unlike his predecessor, who frequently shifted alliances and played important interests off against one another, Brezhnev sought to maintain a balance of supporters from all politically important segments of the Soviet establishment. (p. 9)

Soviet policy under Brezhnev was a time in which there was a focus on consensus, stability and job security of the elites (Bunce and Echols 1980, pp. 8-13). Hough (1972) found evidence of this due to the fact that the turnover of the Soviet elite had declined markedly during the Brezhnev era. Bunce and Echols (1980) defined the Brezhnev period as a corporatist system; one in which policy goals were outlined and the system was then designed to ensure that the goals were fulfilled. Bunce's (1983) later work expanded on the corporatism of the Brezhnev period and the influence of the established system of networks. This period would be one in which there was continuity in elites, and as long as economic goals were maintained there was a more cooperative spirit than was seen under Khrushchev.

Brezhnev's role in Kazakhstan would derive from two related events. First, he spent two years of his career in Kazakhstan, from 1954-1955, in which he was largely responsible for the beginning stages of the Virgin Lands campaign (Narkiewicz, 1986, pp. 100-101). Second, Brezhnev's success in Soviet politics largely resulted from the fact that he was able to promote cadres that worked well with him, thereby establishing a network of loyal contacts early in his career.⁷⁹ One of these cadres was Dinmukhamed Kunaev who was elected as First

⁷⁹ See Olcott, 1995, pp. 240-241 and Kelley, 1980, p. 29.

Secretary of the Kazakh Communist Party Central Committee in January of 1960; with Brezhnev in attendance at the Plenary Session.⁸⁰

Kunaev, in turn would have a great deal of influence in shaping Kazakh politics and leadership during his tenure as first secretary. Kunaev increased the participation of trusted Kazakhs to important positions in Kazakhstan, which happened in the other Central Asian republics during the Brezhnev era.⁸¹ However, what Kunaev did that was unusual, was that he appointed Russians as well as Kazakhs to prominent positions. This decision was likely the result of the higher numbers of Russians in Kazakhstan, versus the other republics, as well as higher integration of Kazakhstan and Kazakhs with Russia as outlined in the previous section. However, this action would undoubtedly have an influence on future politics in Kazakhstan. As Olcott (1995) pointed out

...Kunaev's accomplishments and his place in Moscow's hierarchy remain unique. While ethnic separatism and the racial delegation of responsibility still seem to be the Soviet norms, they were no longer widely practiced in Kazakhstan. (p. 246)

Politics and nationalistic issues in Uzbekistan during the Brezhnev era would undergo a markedly different turn of events.

Sharaf Rashidov would serve as First Party Secretary of the Uzbek Party Central Committee from 1959-1983.⁸² Rashidov would have the greatest impact on Uzbekistan through the implementation of three policy decisions; the cascade

⁸⁰ *Pravda*, January 21, 1960, p. 2; in *The CDSP*, Vol. XII, No. 3, p. 29.

⁸¹ Critchlow (1991) noted that under Brezhnev, native first party secretaries in the Central Asian republics served long tenures, allowing them to appoint other loyal followers to senior positions (pp. 18-20).

⁸² Rashidov was elected as First Secretary on March 15, 1959 (*Pravda*, March 15, 1959, p. 3; in *CDSP*, Vol. XI, No. 9, p. 31).

of the increases in cotton production, the increase of Uzbek officials in key government and party organizations, and a continued focus on the virtues of Uzbek nationalism.

In keeping with the policies of the Brezhnev era, Rashidov was given free reign to run the republic as he wished as long as he continued to increase cotton production to Moscow (Critchlow, 1991, p. 20). Official numbers indicated that in fact, cotton deliveries were proceeding according to, or above planned targets from 1978-1983.⁸³ However, estimates for monies paid by Moscow for cotton that was never delivered ranged from one billion to four billion roubles during this time period (Critchlow, 1988, p. 143).⁸⁴ There were two ways that production amounts were inaccurately recorded.

One way was to bribe the officials at the procurement centers to inflate the amounts actually delivered, the other way was to increase the cultivated area and to conceal this from the statistical agencies (Rumer, 1989, p. 70). Rashidov also set up a network of trusted cadres and elite officials, whom he could count on to go along with falsifying cotton production amounts. One example of this network was the marriage of the daughter of Kalybek Kamalov, who was the head of the Karakalpak ASSR party obkom from 1963 to 1984, to Rashidov's

⁸³ Officials from the Uzbek republic reported that almost one-hundred percent of cotton production plans were met for 1979 and 1982; specifically it was reported that 98 percent of planned procurement was met for 1979 and that 96.3 percent of planned procurement was met for 1982 (*Izvestia*, Dec. 2, 1979 p. 5; in CDSP, Vol. XXX, No. 49, p. 15-16; Ashkhabad Domestic Service, in Russian, 1315 GMT 17 November 1982; in Foreign Broadcast Information Service, (FBIS) November 17, 1982, p. T2.

⁸⁴ Later reports cited more than four billion roubles that had been "stole(n)" from the state (Moscow, *Pravda*, in Russian, January 23, 1988, Second Edition, p. 3; in FBIS, January 28, 1988, p. 58).

son.⁸⁵ Kamalov was later prosecuted for receiving and giving bribes, related to cotton production, while he was head of the Karakalpak party obkom.⁸⁶

So, what were the reasons for the padding of production amounts of raw cotton? Primarily, it was because the procurement amounts set by Moscow were unrealistic. The goals were unrealistic because irrigated land eventually reached its limits. Rumer points out that this process took decades, but that by the mid seventies and early eighties

Fertile soils (had) been depleted, and the acreage under cultivation (had) reached its absolute outer limits, given the available water supplies. Yet Moscow, operating as ever on the principle that one must surpass the "attained level," constantly (raised) the plan targets. There remain(ed) but one alternative: inflation of the data. (1989, p. 71)

While the policies under Rashidov would have such a significant impact on Uzbekistan, they did not really come to light until Brezhnev's death in 1982, and Gorbachev's election as General Secretary in 1985.

The "cotton affair" as the event became known, would be seen and portrayed very differently in Moscow, by Russians, and in Uzbekistan by Uzbeks. Moscow portrayed these events as horrible crimes of corruption and bribery committed against the state, as *Moscow News* reported

The Uzbek case has been the biggest in Soviet postwar history in terms of the sums stolen and the political, economic and social damaged caused by the crime (of corruption).⁸⁷

⁸⁵ Moscow, *Nedelya*, in Russian, No. 29, July 18-24, 1988, pp. 14-15; in FBIS, July 29, 1988, p. 57.

⁸⁶ Moscow, *Trud*, in Russian, August 4, 1988, p. 4; in FBIS, August 15, 1988, pp. 60-63.

⁸⁷ Moscow, in English, No. 14, April 3, 1988, p. 13; in FBIS, April 13, 1988, p. 50.

However, the events were seen in Uzbekistan as an unfair prosecution and portrayal of Uzbeks. Critchlow (1988; 1991) pointed out that many of the officials used the diverted funds for their local communities for necessary, but unauthorized, projects. Additionally, it seemed obvious that the inflation of amounts of cotton delivered to the center could not have been accomplished without the help of Russian officials. This theory was confirmed when Brezhnev's son-in-law, Yuriy Churbanov was linked to the Uzbek cotton affair, and tried along with other executives of the Uzbekistan Interior Ministry for corruption.⁸⁸

Gorbachev's drive to end the corruption that had gone unchecked during the Brezhnev era would involve a campaign to purge of all the republic's elites. On December 15, 1986, Moscow reported that the First Party Secretary in Alma-Ata, A. Koychumanov, was fired for abuses of power. The broadcast went on to state that this dismissal was "the latest in a series of shakeups in Kazakhstan" which included the replacement of seven of nineteen local communist officials.⁸⁹ The next day, December 16, Moscow reported that Kazakhstan's Kunaev was released from his position as First Secretary, "in connection with his retirement on a pension."⁹⁰

The policies of purging the elites would become even more pronounced in Uzbekistan, because Rashidov had promoted higher numbers of trusted Uzbek

⁸⁸ See, for example, Moscow, *Trud*, in Russian, June 18, 1988, p. 2; in FBIS, June 29, 1988, pp. 44-46, and Moscow, *Tass*, in English, 1212 GMT 13 September 1988; in FBIS September 14, 1988, pp. 57-58.

⁸⁹ Paris, AFP in English, 1328 GMT December 15, 1985; in FBIS, January 10, 1986, p. R6.

⁹⁰ Moscow, Domestic Service, in Russian, 0900 GMT December 16, 1986; in FBIS, December 16, 1986, p. R1.

cadres, over Russians, to important party and administrative positions (Critchlow 1991, p. 27-28).⁹¹ Therefore, the purging of the elites in Uzbekistan came to look much more like discriminatory policies aimed at Uzbeks. Gorbachev's policy to replace "corrupt" officials was met with resistance in both republics. Rashidov's replacement in Uzbekistan, Inamzhon B. Usmankhodzhayev, would later be accused of corruption, in taking bribes and falsifying amounts of raw cotton procured.⁹² Islam Karimov replaced Usmankhodzhayev in 1989. Kunaev's replacement in Kazakhstan with Gennadii Kolbin, a Russian, would result in rioting in the capital of Alma-Ata, in which several people were reported killed.⁹³ Nursultan Nazarbayev replaced Kolbin, also in 1989.

The Brezhnev era and policies implemented by First Party secretaries in Kazakhstan and Uzbekistan would influence each republic as it moved towards independence. Specifically, in Uzbekistan, policies that focused on cotton production and growing implemented by Rashidov, would be continued in the post-Soviet era. In Kazakhstan, the policy of including Russians in important positions would be continued.⁹⁴ However, post-Soviet era policies would be aimed at establishing a more independent Kazakhstan, through greater international orientation.

⁹¹ Kunaev did appoint loyal Kazakhs to important positions, including family members and members of the same clan. However, this was common in the other republics, and the resulting advancement of Kazakhs in the educational system was not on the same scale as what had happened in Uzbekistan. See for example "Izvestiya Spotlights 'Web' of Kazakh Corruption", Moscow, *Izvestiya*, in Russian January 24, 1987, p. 3; in FBIS February 11, 1987, pp. R20-R26.

⁹² Moscow, *Moscow News*, in English, No. 14, April 3, 1988, p. 13; in FBIS, April 13, 1988, pp. 50-52.

⁹³ Paris, *Le Monde*, in French, December 21-22, December 1986, p. 4; in FBIS, December 23, 1986, p. R2.

⁹⁴ Nazarbayev would appoint Sergei Tereshchenko, a Russian, as Prime Minister in 1993.

For example, in 1991, while discussing the future implementation of unpopular economic measures that Kazakhstan would follow, Nazarbayev stated that

We will have to grit our teeth the whole way through. It was this way in Turkey and South Korea. Now they have built flourishing societies.⁹⁵

Karimov in contrast, envisioned a different approach to economic reform. In 1991, during a profile piece on the present situation in Uzbekistan he stated that

Shock treatment will not work in Uzbekistan. The Polish model will not work in Uzbekistan. ... So I say that our specific features are special. From that point of view, we cannot agree to shock treatment...⁹⁶

Each president then, had a different view on the appropriate economic reform path that each of his countries should follow.

International Economic Orientation

The differences in integration levels are hypothesized to influence the international economic orientation of each country. Kazakhstan's higher level of integration under the Soviet regime has resulted in more international economic orientation in the post-Soviet era. Conversely, Uzbekistan's lower level of integration under the Soviet regime has resulted in less international economic orientation in the post-Soviet era.

⁹⁵ Moscow, *Interfax*, in English, 1420 GMT, December 10, 1991; in FBIS, December 11, 1991, p. 82.

⁹⁶ Moscow, *Central Television First Program Network*, in Russian, 2055 GMT, October 24, 1991; in FBIS, October 29, 1991, pp. 74-75.

Two related areas of international economic integration will be examined: progress in the trade and foreign exchange system⁹⁷, and the date of each country's acceptance of complete currency convertibility and the lifting of discriminatory currency arrangements. These areas of integration indicate progress in each country in moving from a planned to a more market based economy, through an examination of how open each country is to international economic standards of trade.

The liberalization of the trade and foreign exchange system is necessary for the transition economies "to ensure that liberalized domestic prices for tradable goods and services adjust to world price levels"; in other words to acclimate these countries into the international economic system (EBRD, 1995, p. 18). Table 5.6 charts the progress of Uzbekistan and Kazakhstan on the transition indicator category of Trade and Foreign Exchange System from 1995-2002.

Table 5.6 Comparison of Rating of Trade and Foreign Exchange System for Kazakhstan and Uzbekistan: 1995-2002.

Country	1995	1996	1997	1998	1999	2000	2001	2002
Kazakh.	3	4	4	4	3	3+	3+	3+
Uzbek.	2	2	2-	2-	1	1	2-	2-

Data from EBRD Transition Reports, Transition Indicator Tables, various years. The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little or no change from a rigidly planned economy and 4+ represents the standard of an industrialized market economy (EBRD 2001, p. 13). For the Trade and Foreign Exchange System indicator, a ranking of 4+ also indicates membership in the WTO (EBRD, 2001, p.13).

⁹⁷ This is also an area of economic reform that will be examined more fully in chapters 5 and 6. For the section in this chapter, progress in the ranking of this indicator as compiled in the EBRD Transition Reports will be used.

As table 5.6 indicates, Kazakhstan has consistently been ranked higher than Uzbekistan in its trade and foreign exchange system ranking. Data through 2002 indicate that Uzbekistan had not received its initial ranking of a “2”, in 1995, past 1996, while Kazakhstan had received a ranking of “4” beginning in 1996, and had an average of about a “3+” for data through 2002. Additionally, the differences between a category 2 and category 3 are more substantial than they may appear.⁹⁸ A category 3 indicates that most import and export restrictions have been removed, in addition to almost full current account convertibility at a unified exchange rate (EBRD, 1995, p. 12). Kazakhstan had implemented a liberal trade system by 1997, and by the end of 1995 had ended export quotas, most export and import licensing requirements and had prohibited barter trade (EBRD, 1997, p. 177).

Uzbekistan has made little progress in the removal of import and export restrictions. In the most recent IMF Staff Country Report for Uzbekistan in March 2000, the IMF staff team reported that governmental controls in the trade and exchange system were “extensive even by the standard of transition economies” (IMF, 2000, p. 85). Uzbekistan had also introduced additional restrictions on exports and imports in 2002 (Interview, IMF economists, October 22, 2003). A dominant theory in international economics is that there are gains from trade, and not from distortions on trade. However, Uzbekistan’s unique position of self-sufficiency in the energy, and cotton sectors from the Soviet era may have

⁹⁸ In an interview with an IMF economist, the economist stated that in fact, there was a big difference between a category 2+ and a category 2- (Interview, IMF economist, July 8, 2002).

influenced the governments' reluctance to open the economy to trade. The government may view distortions on trade, in the form of export and import restrictions, as more beneficial than open trade.⁹⁹

Progress in the area of current account convertibility and a decision to comply with a unified exchange rate is closely related to reform in the trade and foreign exchange system. Current account convertibility is also an indicator of a decreasing role of the government in the economy, because currency convertibility means that the currency of a country is convertible at a rate set by the market and not by the government. While Kazakhstan and Uzbekistan have both accepted these obligations, Kazakhstan did so much earlier than Uzbekistan.

A country officially agrees to currency convertibility by accepting Article VIII of the IMF Articles of Agreement.¹⁰⁰ Kazakhstan accepted Article VIII obligations on July 16, 1996 (IMF Press Release, No. 96/41, July 23, 1996). Kazakhstan's acceptance of full current account convertibility was stated as one of the most important economic reforms that the country implemented (Interview IMF economist, July 8, 2002). Uzbekistan has only very recently agreed to currency account convertibility, accepting Article VIII obligations on October 15, 2003 (IMF Press Release, No. 03/188, November 11, 2003). Reasons given for the government's decision to take this step now included the fact that inflation

⁹⁹ Another indication of the government's increased restrictions on trade with surrounding countries was a recent decision to close a bridge connecting Uzbekistan and Kyrgyzstan (Interview, IMF economists, October 22, 2003).

¹⁰⁰ A country notifies the IMF when it is ready to accept Article VIII obligations, and the Executive Board then votes to make the information available on the IMF web site (Interview IMF economists, October 22, 2003). Article VIII, Sections 2,3 and 4 designate that the member will avoid restrictions on current payments, avoid discriminatory currency practices and agree to the convertibility of foreign-held balances (IMF Articles of Agreement, Article VIII).

was less than 20 percent, the country had a satisfactory level of foreign reserves, world prices for gold ¹⁰¹ and cotton were high (reflecting a stronger balance of payments situation) and the black market rate exchange rate was very close to the official exchange rate (Interview, IMF economists, October 22, 2003).

Prior to currency convertibility, Uzbekistan operated under a multiple exchange rate regime, formally implemented in January of 1997 (EBRD, 1997, p. 212). The decision to restrict access to foreign currency was made as a result of pressure on the balance of payments, resulting from high prices for grain imports and a substantial decrease in the cotton harvest, reducing cotton exports (IMF, 1997b, pp. 6-11).¹⁰² Therefore, to make up for imbalances in the terms of trade, the government resorted to intervention in the economy. While Uzbekistan's acceptance of Article VIII obligations was described as a "positive" step in progress on economic reform, it was additionally stated that more extensive reform would be needed in the future including the lifting of trade restrictions (Interview, IMF economists, October 22, 2003).¹⁰³

Conclusion

Differences in the previous three levels of integration have influenced Kazakhstan and Uzbekistan's economic reform processes in the following two areas. In Kazakhstan, there was a greater degree of exposure to and

¹⁰¹ The monthly average gold price increased from \$271.06 (per Troy Ounce) in 2001, to \$308.03 in 2002. Gold had been trading at higher than \$390 per ounce, and was traded briefly at \$400 an ounce on November 23, 2003 (CRB Commodity Yearbook, 2003. p. 112; Fuerbringer, 11, November 2003; pp. C1, C9).

¹⁰² This decision will be analyzed in the next chapter.

¹⁰³ See also "Uzbekistan: *Som* Day Has Arrived, As Currency Convertibility is Announced," RFE/RL Newline, October 10, 2003

relationship with Russia and Russians. This would lead on the one hand to more of a willingness to engage the international community on economic standards that would be needed for the republic to succeed as an independent state. In Uzbekistan, there was less exposure to, and a less positive experience with Russia and the Russians during the Soviet era. This experience coupled with the unique economic position of the republic at independence, would result in less of a perceived need to engage the international community, for the republic to succeed as an independent state.

However, this analysis is only part of a comprehensive understanding of the different economic reform paths that each country would undergo. The end of the Soviet Union provided each republic with independence, and an opportunity for each of the republics' presidents to chart the economic reform process of each country. The next chapter will examine the strategies of each president and the role of the elite to further understand why the two countries followed different economic reform paths.

Chapter 6: The Role of the President and the Elite in the Economic Reform Process

The analysis of differences in the integration levels of Kazakhstan and Uzbekistan during the Soviet era in the previous chapter showed that this variable has influenced the economic orientation of each country. This chapter will expand upon differences in the economic reform processes of each country by examining the role of the president in the economic reform process. Each of these countries began independence with a strong president who would influence each country's progress on economic reform. The chapter will also examine the role of each country's elite, and more specifically, whether the turnover of the former communist elite resulted in the advance or delay of reforms.

Previous studies have examined the impact of political considerations on reform policy. These studies found that countries that kept former communist rulers were less likely to implement reform, regardless of the degree of democratization (ABJ, 1996; Fish, 1998). Kazakhstan has kept its former communist ruler, but the country has implemented the broadest economic reforms of all the Central Asian states.¹⁰⁴ Therefore, this chapter will examine the importance of the relationship between the president and the elite in each country. Specifically, the analysis will focus on whether the elite supported the economic policies of the president. This type of analysis will provide clearer

¹⁰⁴ Personal conversation, IMF economist, September 5, 2001.

information about the differences in the level of advancement of reforms between the two countries.

Background of each Leader and the Relationship of each Leader with the Former First Party Secretary

Nursultan Abishevich Nazarbayev was born in 1940, near Almaty and was employed as a steel worker at the Karaganda metallurgical combine.¹⁰⁵

Nazarbayev rose up through the communist party in Kazakhstan, and on June 22, 1989 he replaced Gennadii Kolbin as Head of the Communist party of Kazakhstan.¹⁰⁶ Kolbin had replaced Kunaev during the purging of the republic's elites under Gorbachev discussed in the previous chapter. Olcott (1995) pointed out that Nazarbayev was likely surprised that he was not chosen to replace Kunaev, considering that he had developed a good relationship with Gorbachev, was a prominent Kazakh in the communist party, and was critical of Kunaev's policies while he was still first party secretary.¹⁰⁷

Nazarbayev had a tumultuous relationship with Kunaev, especially considering the fact that Kunaev was responsible for his promotion from party secretary at Karaganda, to chair of Kazakhstan's Council of Ministers (Olcott, 1995, p. 259). Nazarbayev first began to criticize Kunaev in February 1986, citing among other things poor "methods of administration" (Alexandrov 1999, p.

¹⁰⁵ Vronskaya and Chuguev, 1992, p. 357; Moscow, *Tass International Service*, in Russian, 0954 GMT, June 22, 1989; in FBIS, June 22, 1989, p. 56.

¹⁰⁶ Moscow, *TASS International Service*, in Russian, 0954 GMT, June 22, 1989; in FBIS, June 22, 1989, p. 56.

¹⁰⁷ Gorbachev's drive to end what he viewed as corrupt elite networks likely influenced the decision to promote a Russian and not a Kazakh.

7). In a speech Nazarbayev gave at the 27th CPSU Congress, he cited the need for improvement against the “negative phenomena” that had affected the republic’s national economy, which he attributed to

serious failings and shortcomings in the leadership of the economy... and violations in the principles of social justice as well as in the selection, placement, and training of cadres.¹⁰⁸

Nazarbayev’s subdued attacks on Kunaev steadily increased and by November 1986, Kunaev was describing Nazarbayev as a “dangerous man” and told Gorbachev that he must be stopped.¹⁰⁹ Alexandrov (1999) noted that Nazarbayev’s motives were politically based, and that he believed that distancing himself from Kunaev was a way to move into a more powerful political position. In an interview Nazarbayev gave in April 1990, he admitted to criticizing Kunaev stating that

...I dared to openly criticize D. Kunaev, member of the Politburo, at our party congress. I shall say honestly that I did this after agonizing over it, according to my convictions, remembering who he was and believing that, all the same, time would provide the most correct assessments of him. And my criticism of him was constructive and to the point.¹¹⁰

Nazarbayev did not have a positive view of Kunaev or his policies while he was the First Party Secretary.

Islam Abduganievich Karimov was born only two years earlier than Nazarbayev, in 1938, in Samarkand (Vronskaya and Chuguev, 1992, p. 215).

¹⁰⁸ Moscow, *Pravda*, in Russian, March 5, 1986, p. 4-5; in FBIS, March 14, 1986, pp. O9-O10.

¹⁰⁹ Alexandrov (1999) provided a detailed account of the relationship of the two men, and how they had each worked to undermine the other (6-10).

¹¹⁰ Moscow, *Pravda*, in Russian, February 23, 1990, p. 2; in FBIS April 5, 1990, p. 120.

Karimov was trained as an economist, and was appointed head of Uzbekistan's branch of the Gosplan agency, as well as deputy chair of the Uzbek Council of Ministers in 1986.¹¹¹ Karimov's background in economics, and with Gosplan would greatly influence his ideas about his country's economic reform process.¹¹² One example of this was Karimov's decision by presidential decree, to transform the Uzbek State Planning Committee (Gosplan) into the Uzbek Committee for the Economy.¹¹³ Karimov's political career was also different from that of Nazarbayev, in that he did not rise through the communist party as Nazarbayev had.

Karimov replaced Rafik Nishanov as First Secretary of the Uzbekistan Communist Party on June 23, 1989; one day after Nazarbayev assumed his position.¹¹⁴ Prior to this, in December 1986, Karimov was the first party secretary of the rather remote Kashkadarya oblast.¹¹⁵ Carlisle (1995) pointed out however, that this was an important position because

This form of political exile marked him as a man with a grievance against the Moscow-installed leadership and gave him experience in the CPSU elite, albeit in a backwater region. (p. 196)

Presumably, Nishanov was viewed as "the Moscow-installed leadership" since he had replaced I. Usmankhodzhaev after the latter was removed for charges of

¹¹¹ Moscow TASS International Service, in Russian, 1435 GMT, March 24, 1990; in FBIS, March 26, 1990, p. 137; and see Kangas, 2002, p. 133.

¹¹² An official from the Embassy of Uzbekistan stated that Karimov's economic background would allow him to understand the disadvantages of other economic systems, such as a shock therapy approach to economic reform (Interview, July 11, 2002).

¹¹³ Moscow, *Izvestiya*, in Russian, December 11, 1990; in FBIS, December 14, 1990, p. 102.

¹¹⁴ Moscow, Domestic Service, in Russian, 1100 GMT, June 23, 1989; in FBIS June 26, 1989, p.

70.

¹¹⁵ *Ibid.*,

corruption.¹¹⁶ Karimov came into Uzbek politics as a relative outsider. Yet soon into his position he has kept or brought back many of the older former Soviet elite, many from the Rashidov era. However, Karimov would soon distance himself from many of the influential people who helped bring him to power.

Shakarulla Mirsaidov was responsible for Karimov's position as first secretary, and when the Supreme Soviet elected Karimov president in March 1990, Mirsaidov was made vice president.¹¹⁷ However, it was likely that the two men did not get along, and that Karimov was looking for a way to solidify his power against Mirsaidov.¹¹⁸ The coup attempt in Moscow seemed to provide Karimov with the opportunity that he was looking for. Karimov was in India on an official trip when the coup attempt was reported in Moscow.¹¹⁹ Carlisle (1995) has argued then, that the perception that the Uzbek authorities called for order and did not favor the break up of the Soviet Union, was done when Karimov was not in Uzbekistan; and was thus organized by Mirsaidov and his allies. Therefore, even though Karimov immediately returned to Uzbekistan

...there is reason to believe that the emergency measures imposed in Tashkent were independently taken – perhaps by Mirsaidov and his allies – before Karimov took charge. The failure of the coup thus weakened his enemies in the Tashkent establishment, not Karimov. (Carlisle, 1995, p. 198)

¹¹⁶ See the previous chapter for information on the purging of the elites.

¹¹⁷ Moscow, TASS International Service, in Russian, 1435 GMT, March 24, 1990; in FBIS, March 26, 1990, p. 137.

¹¹⁸ Carlisle (1995) explained that a reliable Uzbek source told him that the struggle was "between two bears that could not continue unresolved much longer" (p. 198).

¹¹⁹ Carlisle (1995) pointed this out in his chapter, on p. 198. For official documentation that Karimov was on a trip to visit India from August 17-19, see Moscow Interfax, in English, 1055 GMT, August 15, 1991; in FBIS August 16, 1991, p. 60.

When Karimov was elected president during the general election, he was then able to solidify his power by decreasing the importance of the vice presidential position, and he eventually abolished the position altogether. Fierman's (1997) analysis of events supports this theory that the two men did not get along with his findings that Mirsaidov was likely trying to gather supporters from Moscow soon after the declaration of independence, in opposition to Karimov.¹²⁰ Karimov's decision to marginalize and eventually oust his former supporter may have also been the result of competing prominent clans in Uzbekistan. Mirsaidov and his allies represented the Tashkent region, while Karimov, Rashidov and I. Dzhurabekov represent the Samarkand region.¹²¹ Karimov's decision to rehabilitate Rashidov, as well as other officials involved in the cotton affair would result in the return of members of the former first party secretary's Soviet era elite.¹²²

Conversely, Nazarbayev's early actions to distance himself from Kunaev would make it easier for him to proceed more independently of the former Soviet elite. For example, in an interview that Nazarbayev gave in April 1991, he stated that, "(t)he trouble with Kunaev the cadre party member is that he is a son of his times." When asked about Nazarbayev's relationship with Gennadi Kolbin,

¹²⁰ Fierman (1997) stated that the "details (were) not clear"; but that Mirsaidov had traveled to Moscow in September, possibly to enlist support (p. 378).

¹²¹ Mirsaidov was formerly the chair of the Tashkent City Soviet Executive Committee (Tashkent Domestic Service, in Uzbek, 0115 GMT March 30, 1986, in FBIS, March 31, 1986, pp. R10-R11). Karimov later dismissed an associate of Mirsaidov, the mayor of Tashkent City, A. Fazyzbekov in July of 1994. Mirsaidov was also a former mayor of Tashkent for five years (Melvin 2000, p. 41; Moscow, TASS International Service, in Russian, 1612 GMT, March 26, 1990; in FBIS, March 27, 1990, p. 121). Ismail Dzhurabekov's influence in Karimov's government will be documented in the next section of the chapter.

¹²² In a meeting of the Uzbek Supreme Soviet on February 22, 1991, 241 cases of persons involved in the "cotton affair" were cleared, and over 1,600 total people involved in the cotton affair had already been rehabilitated (Moscow, *Komsomolskaya Pravda*, in Russian, April 2, 1991, p. 1; in FBIS, April 5, 1991, p. 75).

Nazarbayev confirmed that he talked with him often and stated he believed that Kolbin, "...wanted honestly and conscientiously to do something, to make changes for the better – I can say that firmly".¹²³ The next section will examine the role that the president and each of their views on economic reform.

The Role of a Strong President

Nazarbayev and Karimov each began their role as that of a strong president in their respective countries. The early categorization of both regimes was that they were authoritarian in nature. However, over time some analysts have changed their assessment of Nazarbayev as an authoritarian leader.¹²⁴ Treacher (1996) distinguishes between the "hard" authoritarianism of Uzbekistan and the "soft" authoritarianism of Kazakhstan (p. 313).¹²⁵ Aslund (2002) described Kazakhstan as softening its authoritarian rule, while he stated that Uzbekistan maintained a "severe dictatorship" (p. 65). Aslund's (2003) recent work categorizes Kazakhstan as "mildly authoritarian", and Uzbekistan as a "full-fledged dictatorship" (p. 75).¹²⁶

This categorization of a strong leader is important because it indicates that each leader would have more power over decisions made concerning economic

¹²³ Moscow, *Komsomolskaya Pravda*, in Russian, April 13, 1991, p. 2; in FBIS April 18, 1991, p. 59.

¹²⁴ It should be noted that Martha Brill Olcott, arguably the most prolific writer on Kazakhstan and Nazarbayev, recently argued that the political arena has become more restricted over the past ten years. (Olcott, 2002, pp. 87-89).

¹²⁵ He attributed these differences to factors including culture, religion, economics and the role of Russia (pp. 313-317).

¹²⁶ In this article, Aslund states that all the Central Asian states are considered authoritarian, but that they have "great" differences in pluralism (p. 75).

reform.¹²⁷ The elite in each country will also play an important part in decision-making, but a strong leader in each country indicates that the president exercises considerable control over the elite. This was evident in the power struggle between Mirsaidov and Karimov outlined in the previous section.

Statements made by each leader at the beginning stages of independence were also important in understanding their views on economic reform. There was a brief statement from each president reviewed in the last chapter, but an additional analysis of their remarks and writings is required to better understand their views on the likely path that each president would pursue regarding economic reform. The overarching theme that Nazarbayev would espouse in interviews was that Kazakhstan needed to pursue the transition to a market economy. Karimov, on the other hand would consistently refer to the “special circumstances” of Uzbekistan, and the need for a gradual transition to a free market. He would most often argue that a free market economy was not right for Uzbekistan.

Nazarbayev stated as early as 1991, quite bluntly “We have to transform our economy to a market economy as fast as possible.”¹²⁸

¹²⁷ An economist stated that Uzbekistan’s strong president was able to prevent reforms, while Kazakhstan’s strong president was able to advance reforms (Interview, IMF economist, June 18, 2001).

¹²⁸ London, Press Association, in English, 2028 GMT, October 28, 1991; in FBIS, October 29, 1991, p. 72.

Regarding a continuation of the influence of communist ideology on economic reforms he stated

I believe that we must resolutely separate the economy from ideology. There should be no party influence on economic strategy including influence by the Communist Party.¹²⁹

Nazarbayev realized even before the end of the Soviet Union that he would need to create a new strategy, and a new economy for Kazakhstan to be able to move forward as an independent country.¹³⁰ Nazarbayev also had strong views on his country's progression in many areas as an independent state. In 1990, a declaration was passed declaring a ban on all nuclear testing at the Semipalatinsk region and a ban on any other weapons of mass destruction on Kazakh territory.

In one of his recent books, Epicenter of Peace (2001), he explained the decision of the Kazakhs to voluntarily give up their nuclear weapons, and their status as a nuclear power state. Nazarbayev described in detail that for many years the leadership of the Soviet republic of Kazakhstan was unaware that nuclear testing was done underground in Semipalatinsk (p. 27-34). He also described the lasting effects of the testing on the people of the Semipalatinsk, Pavlodarsk and other regions, that they had resulted in "...cases of miscarriages, (and) premature births... related to genetic mutations caused by short-term and residual radiation" (p. 38). Therefore, there were many reasons for Kazakhstan to give up these weapons. One reason that Nazarbayev explained in his book,

¹²⁹ Moscow, *Komsomolskaya Pravda*, in Russian, April 13, 1991, p. 2; in FBIS, April 18, 1991, p. 54.

¹³⁰ Interview, Official at the Embassy of Kazakhstan, July 11, 2002.

involved his beliefs about Kazakhstan's place in the international community. He stated that the

...possession of nuclear weapons cannot be a stimulus for the development of external integration. In conditions where we could potentially flex our nuclear muscle from time to time, there could be no thought of civilized integration into the world community (p. 50).

Kazakhstan signed the Nuclear Non-Proliferation Treaty in December 1993 (Nazarbayev, 2001, p. 64). These statements and writings indicate an emphasis on the desire for integration with the world community along internationally accepted standards.

Karimov, explained in an interview in September 1991, that Uzbekistan was not ready for a market economy, and that he would follow the Chinese model of limited economic reforms, and would also restrict political demonstrations.¹³¹ He stated further that he was not interested in implementing political reforms such as those advocated by Gorbachev because, "(c)ontrolling and curtailing Communist Party activity today means throwing the economy into chaos."¹³² In one of his early books, Karimov explained that the transition from a planned economy to a market based one would take time, and should happen in different phases.¹³³

¹³¹ Moscow, *Izvestiya*, in Russian, September 18, 1991, p. 1; in FBIS, September 25, 1991, p. 90.

¹³² *Ibid.*,

¹³³ Islam Karimov. 1993. Building the Future: Uzbekistan – Its Own Model for Transition to a Market Economy, Tashkent: Uzbekistan Publishers.

In a later book, Uzbekistan on the Threshold of the Twenty-first Century (1998), he explained an important component of the Uzbek model of market reforms with the statement that

...it is difficult to provide a smooth transition from any administrative-command system to the principles of a market economy when the regulating role of the state is ignored. (p. 115-116)

This book also emphasized the threats to security that Uzbekistan consistently faced, and the need for stability in the country in order to have progress (Karimov, 1998).

Issues of security took on added importance with the assassination attempts on Karimov, the influence of the IMU (Islamic Movement of Uzbekistan) and the Taliban's rise to power in Afghanistan.¹³⁴ However, the focus on security and stability as issues of paramount importance for Uzbekistan were also early themes stressed by Karimov. In an interview in March 1990, he stated that presidential power would ensure order and discipline, which was needed "...for the protection of the interests of (the) citizens."¹³⁵ These issues would continue to be used to justify the Uzbek model of gradual reforms.

Each president began his administration with the state and government officials that had been in place from the Soviet era. This was logical, since both

¹³⁴ In an interview with an official at the Embassy of Uzbekistan, these issues were cited as reasons why economic reforms had to be restricted in late 1996-1997, due to the necessity of the increases in military expenditures. The official explained that there had to be a balance between safety and economic reforms (July 11, 2002).

¹³⁵ Moscow, Television Service in Russian, 1430 GMT, March 26, 1990; in FBIS, March 28, 1991, p. 118.

leaders were former first party secretaries and were the front-runners in their respective elections to the position of president.¹³⁶ This analysis of the elite, as represented by the state and government officials appointed by each country's president will illustrate two trends. First, the analyses will emphasize the difference between continuity in the elite in the Karimov administration, and the change in the elite in the Nazarbayev administration. Hellman (1998) pointed out that one way to measure the power of the former communist elite was to examine the extent of personnel turnover in key economic sectors or government positions. Both presidents have the power to appoint personnel to key governmental positions. The Constitution of Kazakhstan (August 30, 1995), under Article 44 sections (3) and (4) gives the president the right to

(3) appoint a Prime Minister of the Republic with the Parliament's consent; release him from office; determine the structure of the Government of the Republic at the proposal of the Prime Minister, appoint to and release its members, ...

(4) appoint the Chairperson of the National Bank of the Republic of Kazakhstan with the Parliament's consent; release him from office,¹³⁷

The Constitution of Uzbekistan (December 8, 1992), under Article 93 section (9) gives the president the right to

9) appoint and dismiss the Prime Minister, his First Deputy, the Deputy Prime Ministers, the members of the Cabinet of Ministers of the Republic of Uzbekistan, the Procurator-General of the Republic

¹³⁶ Nazarbayev ran unopposed in the elections in December of 1991. Signatures that had supported an opposition candidate "mysteriously" disappeared before they could be properly delivered to the Supreme Soviet. Karimov technically ran in a contested election against Muhammad Salih, but Salih argued that Karimov had manipulated the election to win 86 percent of the 98 percent of voters that participated (Staff of the Commission on Security and Cooperation in Europe, 1992, p. 131-134).

¹³⁷ <http://www.kz/eng/kzinfo/CONST/CONSTENG/ukaz1.htm>

of Uzbekistan and his Deputies, with subsequent confirmation by the Oliy Mazhlis,¹³⁸

Second, the analyses will illustrate that in Uzbekistan, personnel in key governmental positions were often members of the former Soviet elite; would often be trusted by the president to hold more than one position; and many would continue into present governmental positions. In Kazakhstan, there is a progression of personnel in key governmental positions not comprised of members of the former Soviet elite; some degree of key persons being trusted by the president to hold more than one position; and no persons continuing into present governmental positions. Differences in each administration in the continuity and change in the elite will also reflect the progress or delay on economic reforms in each country.

The analysis of persons in key government positions in Uzbekistan and Kazakhstan was performed through the use of several approaches. First, persons in more than one position were identified as having the trust of the president, and were therefore identified as being important. Second, these persons were checked for subsequent years to determine if they continued in the government and if they appeared in the same position, or in different positions. Finally, attempts were made to determine if the officials held positions in the government during the Soviet era. Therefore, not all positions or persons will appear in the analyses of the elite.

¹³⁸ <http://www.gov.uz/eng/constitution/index.shtml>

The President and the Elite: Analysis of the Early Uzbek Government and Early Reforms

The important persons and/or positions in the early Uzbek government are listed in Table 6.1.

Table 6.1 Uzbek State and Government Officials, November 1992

Title	First Name	Last Name
Prime Minister, Chair Comm. Reception and Distribution Foreign Humanitarian Aid	Abdulhashim	Mulatov
First Deputy Prime Minister	Ismail	Dzhurabekov
Deputy Prime Minister, Installation Special Construction Work	Pulat	Nugmanov*
Deputy Prime Minister, Minister of Labor	Alikhan	Atadzhamov
Minister of Economy, Chair State Committee Statistics	Bakhtyar	Khamidov
Construction Materials Industry	Inom	Iskandarov*
Defense	Lt. Gen. Rustam	Akhmedov
Foreign Economic Relations	Utkur	Sultanov
Oblast Administrator Tashkent City	Atkhambek	Fazylbekov

Source: Russia and Eurasia FFA, 1993, p. 517-520; Tashkent, *Pravda Vostoka*, in Russian, March 31, 1990, p. 1; in FBIS, April 16, 1990, p. 137.

*Listed in the Uzbek Council of Ministers for April of 1990 in the following positions; Minister of Installation and Special Construction Work, Pulat Nugmanov; Minister of the Construction Materials Industry, Inom Iskandarov.

Many of these officials will continue as subsequent Uzbek governmental officials, likely due to their relationship with Karimov during the Soviet era. In an analysis of FBIS reports, I. Iskandarov's name is first noted in November 1987. He is listed as the deputy chairman of the Uzbek USSR Council of Ministers as well as

the chair of the Uzbek SSR Gosplan.¹³⁹ As pointed out previously, Karimov was trained as an economist and had worked for Gosplan for a number of years, so it is likely that Karimov came into contact with Iskandarov during this time. Rumer confirms Iskanderov's background as an economist and cited Iskanderov's concern about Uzbekistan's lack of a textile industry (Rumer, 1986, pp. 74-75). Iskandarov would remain in the Uzbek government, in the position of construction materials, until December of 1998.¹⁴⁰

An additional person from the Soviet era would be appointed to a position in the construction field in 1993. Table 6.2 shows the continuation of some members of the Uzbek government, with the addition of Kudratilla Mahamadalyev as the Minister of Construction.

Table 6.2 Uzbek State and Government Officials, October 1993

Title	First Name	Last Name
Prime Minister	Abdulhashim	Mulatov
Minister of Agriculture	Mirzajon	Islamov
Minister of Construction	Kudratilla	Mahamadalyev*
Minister of Defense Affairs	Lt. Gen. Rustam	Akhmendov
Minister of Industrial Construction Materials	Inom	Iskandarov
Minister of Foreign Economic Relations	Utkur	Sultanov

Source: Russia and Eurasia FFA, 1994, p. 619-620; Tashkent, *Pravda Vostoka*, in Russian, March 31, 1990, p. 1; in FBIS, April 16, 1990, p. 137.

*Listed in the Uzbek Council of Ministers for April of 1990 in the following positions; Minister of Construction, Kudratilla Mahamadalyev.

¹³⁹ Tashkent Domestic Service, in Uzbek, 0215 GMT, October 28, 1987, in FBIS, November 9, 1987, p. 60).

¹⁴⁰ Iskandarov was listed in the government in January 1998, but not for December 1998 (Russia and Eurasia FFA, 1997, p. 493; Russia and Eurasia FFA, 1999, p.425).

Kudratilla Makhamadaliyev was noted as being appointed as deputy chairman of the Uzbek Council of Ministers in February 1986.¹⁴¹ Makhamadaliyev would remain in the Uzbek government as Minister of Construction until December 1998, when there is no person listed as Minister of Construction (Russia and Eurasia FFA, 1999, p. 425). The appointment and continuation of these two men from the Soviet era into the Karimov government indicate two trends. First, all three men were in the Uzbek Council of Ministers in 1986-1987. Therefore it is very likely that Karimov appointed these men to these positions because he either trusted them or needed their support to solidify his political power base. Since these were likely important men, it would appear strange that they would not have been in more prominent positions such as the Minister of Foreign Economic Relations.¹⁴²

The Minister of Foreign Economic Relations is an important ministry because it controls trade matters. The responsibilities of the Ministry include

...negotiating trade agreements with non-traditional trading partners as well as those arrangements denominated in hard currency with traditional trading partners, and for implementing foreign trade agreements and external trade policy through the issuance of licenses and export quotas. (IMF, 1995, p. 34)

The ministry would then have control over the export quota and export licensing restrictions of goods from Uzbekistan. Specifically, goods that provide needed revenue for the state such as cotton, gas and natural resources. Therefore, this

¹⁴¹ Tashkent, *Pravda Vostoka*, in Russian, February 21, 1986; in FBIS, March 31, 1986, p. R13.

¹⁴² During the Soviet era, an appointment in the Uzbek construction sector seems to have been an important and lucrative position. During the early purges of the Uzbek elite, the head of the Ministry of Construction was accused of corruption for abusing his position for his "personal enrichment" (*Pravda Vostoka*, November 22, 1986, pp. 2-3; in CDSP, vol. XXXVII, No. 51, p. 5). Lubin also pointed out that corruption was common in the construction sector in Uzbekistan because it was easy to steal and then resell materials to supplement ones income (1984, p. 193).

Ministry would continue to be one of the most important ministry's in Uzbekistan.¹⁴³ Decisions made by this Ministry will be examined more fully in the section on the delay of economic reforms in Uzbekistan.

There are also many members of the government who did not appear in 1993, but who reappear in 1994, and continue in place into the late 1990's. For example, I. Dzhurabekov is listed as First Deputy Prime Minister, and B. Hamidov is listed as a Deputy Prime Minister, as well as Minister of Finance. U. Sultanov is appointed Deputy Prime Minister, as well as continuing as Minister of Foreign Economic Relations. Since there is the return of many members of the government in 1994, it is likely that Karimov was making adjustments to consolidate his power base, in addition to making decisions on economic reforms. Uzbekistan also held its first legislative elections in December of 1994, for 250 seats in the *Oliy Majlis* (Supreme Council). However, these elections were not considered free or fair, and the candidates largely supported the president (Nations in Transit, Freedom House, 1998, p.645).

Significant progress in systemic reforms was made after the presidential decree issued on January 21, 1994, "Measures to Further the Economic Reforms, Ensure the Protection of Private Property, and Develop Entrepreneurship." This decree advanced the privatization program to medium and large enterprises as well as passing a new law on foreign investment (IMF,

¹⁴³ In a question posed in an interview with an IMF economist, and in an interview with an official from the Embassy of Uzbekistan, both persons stated that the most important Ministry for making decisions regarding economic reform was the Ministry for Economics and Statistics. The Ministry responsible for decisions about trade and for decisions made about cotton exports and other exported goods was the Ministry of Foreign Economic Relations (Interview, IMF economist, July 8, 2002; Interview, Official from the Embassy of Uzbekistan, July 11, 2002).

1995a, p. 13). Although, EBRD economists noted that Uzbekistan's mass privatization process may have resulted in the concentration of ownership "in the hands of insiders (workers¹⁴⁴ and management)"; which might have hindered more efficient restructuring of enterprises (EBRD, 1995, p. 16). Advancement in the privatization of small enterprises was also noted by 1995, but the decision to postpone privatization in the energy, and telecommunications sectors was described as possibly hindering investment in these sectors in the future.¹⁴⁵

The foreign exchange system in Uzbekistan also underwent significant changes during 1994. The first currency, the *som coupon* was replaced by the *sum* on July 1, 1994. The *som* was a convertible currency for some transactions, but with limitations. For example, by January 1994, restrictions on bringing in foreign exchange into and out of Uzbekistan were removed, but limits were placed on the amounts of foreign exchange residents could buy from authorized banks in Uzbekistan. In July 1994 the amount was US\$250, in August it was increased to US\$1000, but by December the limit was reduced to \$300 (IMF, 1995a, p. 39). These restrictions were put into place to restrict the amounts of foreign exchange leaving the country. Also on November 15, 1994, a resolution was passed decreeing that

...30 percent of foreign currency proceeds subject to compulsory sale by enterprises and establishments, irrespective of their form of ownership, are to remain as a whole at the disposal of the Central Bank of the Republic of Uzbekistan.¹⁴⁶

¹⁴⁴ Although, the workers did not really "own" property under communism.

¹⁴⁵ The EBRD economists stated that these sectors are often "bottlenecks" to the private sector, and that early policy choices concerning this sector may influence future investment (1995, p. 16).

¹⁴⁶ Tashkent, *Narodnoye Slovo*, in Russian, November 9, 1994, p. 1; in FBIS, November 9, 1994, p. 54.

So there were some restrictions on foreign exchange, but the country was making progress on its foreign exchange and trade liberalization system, in 1994 and into 1995.¹⁴⁷

Foreign trade liberalization was also accelerated in early 1995, as seen in the reduction in the number of product categories subject to export quotas, from seventy to eleven categories. However, cotton and gas still had export quota and export licensing restrictions, which represented more than half of Uzbekistan's non-gold exports (EBRD, 1995, p. 63). By the end of 1995 there were only four products that had export quotas, and had to go through export licensing systems: cotton, oil, ferrous, and non-ferrous metals (EBRD, 1996, p. 183). Even though the overall number of products had been reduced, there were still restrictions on goods that were deemed important to the state. For example, in 1994, a Soviet style state order system was still in effect for domestically produced goods such as cotton, grain and other goods such as gold and copper (IMF, 1995a, p.13). This type of order system requires that a percentage of certain goods produced be turned over to the state.¹⁴⁸

Uzbekistan had made enough progress on economic reforms, by late 1994, to be approved for a Stand-by Arrangement from the IMF on December 18, 1995. The IMF noted that the objectives for the economic program for October 1995-December 1996, would include consolidating "... the gains made so far in

¹⁴⁷ This progress by Uzbekistan on this area of economic reform is important, because significant changes including the introduction of the Multiple Exchange Rate system (MER) will be introduced at the end of 1996, and the internal exchange rate would not be unified again until October of 2003.

¹⁴⁸ In August 1994, the orders for cotton and grain were reduced from 75 to 67 percent for the total crop from 1994 (IMF, 1995a, p. 13).

macroeconomic stabilization, and to lay the foundation for economic recovery and improved living standards.” Furthermore, the IMF stated that these objectives would be achieved by “...accelerating market-oriented reforms and *reducing administrative interventions in the economy*” (emphasis added).¹⁴⁹

This loan by the IMF to support Uzbekistan’s 1995-1996 economic program was an important indicator of Uzbekistan’s progress thus far on economic reform.

This early analysis of the Uzbek government, and progress on economic reform shows three important trends. First, it shows that Karimov had complete control over the appointment of officials, and of the legislature. There was no evident friction between the president and the legislature in passing legislation, or decrees.¹⁵⁰ These actions provide evidence that Karimov as a strong leader exercises considerable control over the elite. Second, Karimov used this control to appoint persons from the former Soviet era elite to important positions in his new government. This indicates a low turnover of the former Soviet elite. Finally, Uzbekistan did make some progress on economic reform in these early years, in important areas such as trade liberalization and limiting the restrictions on export licensing and quotas. However, goods deemed important to the state such as cotton, grain, and gold continued to be controlled by the state, specifically by the Ministry of Foreign Economic Relations. The following section will look at the early Kazakh government and economic reforms in 1992, and

¹⁴⁹ IMF Press Release, No. 95/67, December 18, 1995.

¹⁵⁰ There is a general pattern in the implementation of laws in Uzbekistan. First, a presidential decree is issued on a topic. Soon afterward, the Cabinet of Ministers then passes a decree on the same topic, usually within a few months and having a slight variation in the title of the presidential decree.

1993, with substantial attention paid to events occurring in 1994 and the beginning of 1995.

The President and the Elite: Analysis of the Early Kazakh Government and Early Reforms

Most of the officials from the early Kazakh government (the former Soviet elite) do not continue as subsequent government officials for two reasons (see Table 6.3).¹⁵¹ First, it is unlikely that many of these officials had a relationship with Nazarbayev, similar to the relationship that Karimov had with persons during the Soviet era. Second, the make up of the state and government officials would be altered based on numerous changes in the political situation in Kazakhstan beginning in December 1993. This is a very different situation than what occurred in Uzbekistan, and the following section will illustrate the similarities in the 1992 and 1993 Kazakh governments (during the non-compliant parliament) and the similarities in the subsequent late 1994, and 1995 Kazakh governments (during the compliant/non-existent parliament).

Table 6.3 indicates important persons and/or positions among the Kazakh State and Government officials.

¹⁵¹ Sergei Tereshchenko is a notable exception and he would be appointed Prime Minister in October of 1993.

Table 6.3 Kazakh State and Government Officials, November 1992

Title	First Name	Last Name
Vice President, Chair Commission for the Attraction and Use of Foreign Investments	Yerik	Asanbayev*
State Counsellor, Deputy Prime Minister	Myrzatai	Dzholdasbekov
Security Council Chairman	Nursultan	Nazarbayev
Member, Commission for the Attraction and Use of Foreign Investments, Chair Foreign Economic Relations	Sydyk	Abishev*
Member, Commission for the Attraction and Use of Foreign Investments	Tleukan	Kabdrakhmanov
Member, Commission for the Attraction and Use of Foreign Investments, First Deputy Prime Minister	Daulet	Sembaev
Chair National Agency on Foreign Investment (subordinate to Commission Chair), Prime Minister	Sergei	Tereshchenko*
Deputy Prime Minister, Minister Energetics and Fuel Resources	Kadyr	Baikenov*
Deputy Prime Minister, Minister of Agriculture	Baltash	Tursumbaev*
Minister of Defense	Gen. Sagadat	Nurmagambetov*
Minister of Material Resources	Kanat	Turapov*
Deputy Prime Minister, Minister of Tourism, Culture, Physical Sports	Karatia	Turysov
Minister of Architecture and Construction	Askar	Kulibaev

Source: Russia and Eurasia FFA, 1993, pp. 311-314.

*Also listed in October 1993 government.

There is one person listed in the 1992 and 1993 Kazakh government that was part of the Soviet era elite. Yerik Asanbayev was listed as the chair of the

Supreme Soviet in October 1990, and when Nazarbayev was sworn in as President before the Supreme Soviet in December 1991, he was then made vice president of the Republic of Kazakhstan.¹⁵² Asanbayev would continue in the position of vice president, until the new Constitution of Kazakhstan was adopted in August 1995, when there was no longer a vice presidential position.¹⁵³ It is interesting to note the similarities between the actions of the two presidents toward their vice presidents. Karimov and Nazarbayev each had vice presidents from the Soviet era, and they both abolished the position (and ousted the person), likely in an attempt to consolidate their own power.

There were also some persons listed in the Kazakh government in 1990 and 1992, who were appointed by Nazarbayev, but then did not appear in later Kazakh governments. U. Karamonov was appointed as a Prime Minister in November 1990, by Nazarbayev and was subsequently listed as a State Counselor in the 1992 government, but was not listed in subsequent governments.¹⁵⁴ Nazarbayev appointed O. Zheltikov as Trade Minister in June 1990, and he kept that position in 1992, but he was also not listed in subsequent governments.¹⁵⁵ This was a very different situation from that of the early Karimov government when persons would be shifted around, or not be listed in official positions, but then would reappear in later government positions.

¹⁵² As reported by Alma-Ata Kazakh Radio Network in Kazakh and Russian, 1009 GMT, on December 10, 1991; in FBIS, December 11, 1991, p. 82. The Kazakh parliament adopted a law instituting the position of vice president in November 1990 (Moscow, *Izvestiya*, in Russian; November 22, 1990, p. 1; in FBIS, November 23, 1990, p. 53).

¹⁵³ The first constitution of Kazakhstan was adopted in January 1993. A new constitution was adopted by referendum on August 30, 1995. This new constitution does not mention a position of vice president (see Articles 47 and 48).

¹⁵⁴ Moscow, *Izvestiya*, in Russian; November 22, 1990, p. 1; in FBIS, November 23, 1990, p. 54.

¹⁵⁵ Alma-Ata, *Sotsialistik Qazaqstan*, in Kazakh, June 6, 1990, p. 1; in FBIS June 15, 1990, p. 132.

Kazakhstan proceeded with some economic reforms during 1992 and 1993. In January 1992, most prices were liberalized, except for prices on bakery goods and bread that were liberalized in November 1994 (EBRD, 1995, p. 45). Kazakhstan's privatization program for the largest enterprises began in 1993, and the privatization program for the privatization of medium sized enterprises continued through 1995 (EBRD, 1995, p. 45). The EBRD economists noted that Kazakhstan, unlike Uzbekistan, was offering investors "significant minority interests" in its strategic sectors such as energy and telecommunications.¹⁵⁶ The country introduced its own currency the *tenge* on November 15, 1993 (IMF, 1995b, p. 1).

Also in November 1993, Nazarbayev had submitted a resolution to allow the president and the government to speed up decisions on economic reform, which the Supreme Soviet rejected.¹⁵⁷ Olcott (1997) has pointed out that the legislature was comprised of the senior political elite of Kazakhstan, and that it "...was a balky and slow-moving partner for the task of economic and political reform" (p. 220).

Therefore, on December 10, 1993, Nazarbayev persuaded the Supreme Soviet, the first parliament elected in March 1990, to pass two pieces of legislation. The first law "On the Temporary Delegation of Additional Powers to the President of Kazakhstan and Local Chief Administrators" gave Nazarbayev the right to implement decrees which would have the force of law, until the

¹⁵⁶ Additional countries that adopted these policies for privatization of these sectors included Hungary and the Czech Republic (EBRD, 1995, p. 16).

¹⁵⁷ Moscow, Interfax, in English, 1733 GMT, November 22, 1993; in FBIS, November 23, 1993, p. 62.

elections of a new parliament to be held in March 1994. The second law "On the Early Termination of the Powers of the 12th Supreme Soviet of Kazakhstan at the End of Its 11th Session," basically dissolved the current parliament until the March elections.¹⁵⁸ Nazarbayev's reasons for taking this action were likely due to his unhappiness with the parliament's progress on economic reform.¹⁵⁹

The second parliamentary elections were held on March 7, 1994. Nazarbayev took a number of steps to ensure that this legislature would be more compliant than the last. For example, the new Parliament, the Supreme Kenges would have a total of 177 seats. Of these seats, the election law allocated 42 seats for candidates on the "president's list" of 64 persons nominated directly by Nazarbayev. The remaining 135 seats would be filled through elections from the territorial populations. Voters received two ballots for parliament, one for the state list and one for the territory list.¹⁶⁰ The report by the CSCE Parliamentary Assembly concluded that because of instances of multiple voting, the separate state list of candidates, and the short period of the campaign that the election was not considered free and fair. The official response of the government was to defend the election proceedings as democratic, while noting that Kazakhstan was not yet ready for a Western-style democracy.¹⁶¹ The report by the CSCE

¹⁵⁸ See *Sevodnya*, December 11, 1993, p. 4; in Current Digest of the Post-Soviet Press, (CDPSP) Vol. XLV, No. 50, p. 24.

¹⁵⁹ The Kazakh ambassador to Moscow, Tair Mansurov would later categorize this parliament, as well as the parliament elected in 1994 as "unwieldy" and "unable to function" (*Kommersant-Daily*, July 6, 1995, p.4; in CDPSP, Vol. XLVII, No. 27, p. 21).

¹⁶⁰ Information on the March 7, 1994 parliamentary elections was compiled from the "Report on the March 7, 1994 Parliamentary Election in Kazakhstan", prepared by the Staff of the Commission on Security and Cooperation in Europe, March 1994.

¹⁶¹ Nazarbayev had argued that the elections had been democratic, while also noting that Kazakhstan was moving toward European standards of democracy (Staff of the Commission and Security and Cooperation, (CSCE) in Europe, 1994, p. 12-13).

concluded that the new parliament would be unlikely to diminish the power of the president. Ironically, the report also mentioned that

...several people commented to Commission staff that the new parliament would not be as compliant as the old one, especially with deputies now enjoying a power base and a 5-year term.¹⁶²

However, the new parliament, the Supreme Kenges and the President would have differences of opinion on economic reform early in their new relationship. One of the main areas of disagreement was the budget for 1994, endorsed by presidential decree in January 1994.¹⁶³ In May 1994, the Supreme Kenges issued a lengthy statement on the Kazakh Radio Network, critical of the government's economic reform program. In part, the statement explained that the government was actually impeding progress toward a market economy, instead of moving forward as the government had claimed. The statement continued that therefore,

...the democratically elected Supreme Kenges, reflecting the will of the majority of voters expressed by the latter during many pre-election meetings, must express a lack of confidence in the government's social, economic and legal policy.¹⁶⁴

The area of disagreement centered around the fact that the Supreme Kenges believed that the Nazarbayev government was moving too fast on

¹⁶² CSCE, 1994, p. 14.

¹⁶³ One of the first areas that the Supreme Kenges stated that it would devote attention to was the "examination of the president's decrees adopted in absentia of the legislative body of power"; referring to the time period between when the Supreme Soviet was dissolved in December of 1993, and March of 1994, the current parliament. The new budget for 1994 was passed by presidential decree in January, which is undoubtedly one decree the Supreme Kenges was referring (see Almaty, Kazakh Radio Network in Kazakh, 1400 GMT, May 30, 1994; in FBIS, May 31, 1994, p. 75

¹⁶⁴ Almaty Kazakh Radio Network, in Russian, 0800 GMT, May 30, 1994; in FBIS, May 31, 1994, p. 74.

measures of economic reform, and specifically that reforms needed to better protect the population. The next day, the press service of the Cabinet of Ministers released a statement via the same media. First, the statement declared that the according to the constitution (of 1993), that it was unconstitutional to declare a statement of no confidence in the government. The statement continued that, according to the constitution, "the Cabinet of Ministers is answerable to the president of the republic." As evidence of the disagreement between the two groups in the area of economic reform, the statement explained that, "(i)n the present social and economic situation a painful transition period is unavoidable..." and further that

The government ha(d) submitted about 60 draft laws to the Supreme Kenges on urgent and topical issues of economic reform, law and order and others. Adoption of these and other documents could have made it possible to improve the legal basis of the reform, to increase purpose-oriented social protection of the population.¹⁶⁵

In a later statement, the government stressed that it would pursue the stringent financial policy and budget deficit target of no more than 4 percent of GDP for the year that it had agreed upon with the IMF.¹⁶⁶ Kazakhstan had concluded a Stand-by Arrangement with the IMF on January 26, 1994, of which this tight budget policy was a "key element of the policies" (IMF Press Release, No. 94/2; IMF, 1995, p. 3).

The stalemate between the parliament and the government would not improve. In the beginning of June the press secretary of the Tereschenko

¹⁶⁵ Almaty, Kazakh Radio Network in Kazakh, 0800 GMT, May 31, 1994; in FBIS, May 31, 1994, p. 75.

¹⁶⁶ Moscow, Interfax, in English, 1102 GMT, May 31, 1994; in FBIS, June 1, 1994, p. 52.

government stated again that the declaration made by the Parliament was unconstitutional and that the Tereschenko government was a capable governing body.¹⁶⁷ The tone in Kazakhstan had reached that of an economic and political crisis. The newly elected Parliament with its statement of no confidence in the Tereschenko government was effectively stating that the government should resign. The government and Nazarbayev were arguing that according to the constitution, the government was only responsible to the president, and that in effect the parliament needed to act to pass the legislation that had been submitted.

By mid-June Nazarbayev became more involved in implementing changes in the government by removing two Minister officials and abolishing the both of the Ministries completely. Kadyr Baykenov, formerly the Minister of the Power, Engineering and Fuel Resources Ministry was removed, as was Igor Ulyanov, formerly the Minister of Communications.¹⁶⁸ On the same day it was also reported that Nazarbayev had issued a presidential decree "On Additional Measures to Ensure Legality and Law and Order"; which was to address the lack of effectiveness of law and order in Kazakhstan. The decree also mentioned the dangers of "...the continuing growth in organized crime, corruption, embezzlement, and abuse by officials."¹⁶⁹ By passing this decree Nazarbayev would then be able to justify the release of future ministers as well as a continuing reorganization of the government. On June 17, Nazarbayev "relieved"

¹⁶⁷ Moscow, Interfax, in English, 1635 GMT, June 2, 1994; in FBIS, June 3, 1994, p. 56.

¹⁶⁸ Almaty, Kazakh Radio Network, in Kazakh, 1400 GMT, June 14, 1994; in FBIS, June 15, 1994.

¹⁶⁹ Almaty, Kaztag, in Russian, 1300 GMT, June 14, 1994; in FBIS, June 15, 1994, p. 49.

O. Zheltikov of his position as Minister of Trade because the ministry was being "reorganized." Nazarbayev had previously appointed O. Zheltikov to this position in June 1990.

The fact that the decree on corruption was implemented soon before the changes in officials indicates that Nazarbayev was concerned about some of the motivations of the ministers, and this is probably a reason as to why they were relieved. In late June, Nazarbayev released a statement stating that he supported the reorganization of the ministries and personnel changes because "...new, younger people having a good idea of what business and economic reform are about have joined the Cabinet." Nazarbayev also explained that the government would have fifteen months to implement the new program, and that if it could not be implemented that the Cabinet would resign.¹⁷⁰ However, in September, two members of the Cabinet Mars Urkumbayev, the Minister of Economics and Vladimir Shumov the Minister of Internal Affairs, were both charged with abusing their official positions and were both relieved of their positions by presidential decree.¹⁷¹ This apparent scandal in addition to the earlier crisis of the no confidence vote in the Tereshchenko government was too much to be dismissed, and on October 12, 1994, Nazarbayev asked for and received the resignation of Tereshchenko and the entire Cabinet of Ministers.¹⁷² The Parliament then approved the appointment of Akezhan Kazhegeldin as the new Prime Minister; Nazarbayev had appointed him First Deputy Prime Minister

¹⁷⁰ Moscow, Itar-Tass, in English, 1222 GMT, June 22, 1994; in FBIS, June 23, 1994, p. 50.

¹⁷¹ *Pravda*, September 23, 1994, p. 1; in CDPSP, Vol. XLVI, No. 38, p. 23.

¹⁷² *Sevodnya*, Sevodnya Business News Agency, October 12, 1994, p.1; in CDPSP, Vol. XLVI, No. 4, p. 23.

in 1994. The Parliament also confirmed the beginning of the new government proposed by Nazarbayev (see Table 6.4).

Table 6.4 Kazakh Government Officials appointed by Nazarbayev on October 12, 1994; and listed in October 1995 Government.

Title	First Name	Last Name
Prime Minister	Akezhan	Kazhegeldin*
First Deputy Prime Minister	Nigmatzhan	Isingarın*
Deputy Prime Minister	Viktor	Sobolev*
Deputy Prime Minister	Vitaly	Mette*
Deputy Prime Minister	Akhmetzahn	Yesimov*
Deputy Prime Minister (October 1994)	Altynbek	Sarsenbayev
Minister of Foreign Affairs	Kasymzhumart	Tokayev*
Minister of Internal Affairs	Bulat	Bayekenov*
Minister of Defense	Sagadat	Nurmagambetov
Minister of Information, Mass Media	Altynbek	Sarsenbayev
Minister of Science, New Technologies	Vladimir	Shkolnik

Source: *Sevodnya*, October 13, 1994, p. 5; in CDPSP, Vol. XLVI, No. 41, p. 23; Russia and Eurasia FFA, 1996, p. 238.

*Was listed in the previous Tereschenko government of 1994, but held a different position. S. Nurmagambetov, A. Sarsenbayev, and V. Shkolnik held the same position in the 1994 Tereschenko government. The Tereshchenko government only had three persons listed from the previous 1992 government; Y. Asanbayev, S. Tereshchenko, and S. Nurmagambetov (see Table 6.3).

The fact that Nazarbayev re-appointed some persons from the failed 1994

Tereschenko government is not surprising because there were some ministers and other official persons whom he either trusted, or had agreed with his plan for the progress on economic reforms for Kazakhstan; or both. However, the new Kazhegeldin government would not fare much better with the current parliament.

In March 1995, the Kazakh Constitutional Court ruled that the parliamentary elections held in March 1994 were invalid. The decision in and of itself was not so shocking considering that international observers had not

considered the elections to be completely free nor fair. Olcott (1997) pointed out that Nazarbayev was likely somewhat responsible for the Court's decision, and that his subsequent decision to once again dissolve the parliament, was not unexpected since the parliament was still "...mounting opposition to (Nazarbayev's) course of privatization and economic reform" (p. 227).

Nazarbayev's comments following the dissolution of parliament focused on the idea that the current constitution should be reformed so that the powers of the parliament would be curtailed.¹⁷³

In an address before the Assembly of the Peoples of Kazakhstan, the president's new group to which he would consult, Nazarbayev made the following statements about the changes that would take place in the near future. Because of the importance of Nazarbayev's statements some of the sections will be quoted in their entirety.

The executive branch of the government seems to be a tasty morsel to deputies because it has real power. The legislative power always traditionally encroaches on its functions. This causes conflicts that seem to an outsider to be the suppression of the legislative power by the executive power. But, in actual fact, this is the executive power's actions to protect itself against the legislative power's encroachments

It is necessary to carry out constitutional reforms. A two-chamber parliamentary system is needed. Each branch of power should carry out its own business without encroaching on another's sphere of authority. If the practice of a tug-of-war emerges, if parliament becomes a political club for deputies to express themselves rather than a legislative body, there will be no tranquility in society.

¹⁷³ *Nezavisimaya gazeta*, March 21, 1995, p. 1; in CDPSP, Vol. XLVII, No. 12, p. 24.

Finally, Nazarbayev explained his decision to rule by presidential decree and without a parliament until the next elections scheduled for December of 1995.

He stated that

I will use this period without parliament to strengthen order in the state and to conduct a resolute fight against crime. In recent days presidential edicts have introduced very decisive changes in the present laws relating to the fight against corruption. In its confrontation with the criminal world, society should have the advantage.¹⁷⁴

It is likely that he is referring here to the corrupt persons mentioned earlier in the Tereschenko government. Nazarbayev would also keep many of the persons listed in his government for October 1994, in October 1995 (see Table 10).

The next section will analyze the differences in the progress on economic reforms during two important time periods. In Uzbekistan, economic reform was delayed, or reversed, as a result of pressure on the balance of payments in 1996-1997. In Kazakhstan, economic reform was advanced as a result of Nazarbayev's rule by Presidential decree from March – December of 1995.

The Delay of Economic Reforms in Uzbekistan and the Advancement of Economic Reforms in Kazakhstan *Uzbekistan*

As explained in the section on the early reforms of Uzbekistan, the country was making some progress on its economic reform program. An important indicator of this progress was the Stand-by Arrangement (SBA) approved by the

¹⁷⁴ Almaty Kazakh Television First Program Network, in Russian, 1507 GMT, March 24, 1995; in FBIS, March 27, 1995, pp. 68-70.

IMF to support the government's program. However, as explained in the section on the early reforms, the Uzbek government was still intervening in sectors deemed important for the economy and the functioning of the state; most notably in agriculture and on export restrictions on gold.

Three events occurred in late 1996, early 1997, that would result in the delay of economic reforms in Uzbekistan. First, there was a significant decline in the cotton harvest in Uzbekistan in 1996. In 1996, output in the agriculture sector fell 7%, largely the result of adverse weather conditions for cotton growing. The summer months were not as warm for cotton growing and there were heavier than normal rains in September (IMF, 1997b, p. 11). The gross harvest of raw cotton fell from 3.9 million tons in 1995 to 3.3 million tons in 1996 (CIS Statistical Yearbook, 2002, p. 666). This was especially problematic because cotton exports are one of Uzbekistan's largest revenue earners. Uzbekistan's balance of payments situation from 1995-1997 would undergo significant changes, most evident in 1997, as a result of the poor cotton and grain harvests from 1996 (see Table 6.5).

Table 6.5 Uzbekistan: Balance of Payments, 1995-1997
(in millions of US dollars)

	1995	1996	1997
Current Account	-21	-980	-584
Merchandise Trade Balance	237	-706	-72
Exports	3,475	3,534	3,695
Cotton fiber	1,584	1,539	1,390
Gold	611	906	738
Energy	436	277	528
Other	844	813	1,039
Imports	-3,238	-4,240	-3,767
Foodstuff	-618	-1,252	-786
Energy Products	-53	-45	-23
Machinery	-1,151	-1,542	-1,868
Other	-1,415	-1,402	-1,091
Memorandum items:			
Price of cotton exports (US dollars/ton)	1,754	1,592	1,582
Price of wheat imports (US dollars/ton)	153	251	223
World gold price (US dollars/ounce)	384	388	331

Data from IMF 1998, p. 109.

The second problem that affected the balance of payments situation was the increase in the price of wheat imports in 1996 (see Table 6.5). During this period, the Uzbek government had been trying to increase its grain production to achieve food self-sufficiency, and to decrease the dependence on importing food (IMF, 1997b, p. 11-12).¹⁷⁵ Therefore, the situation in 1996, was a combination of "...stagnating exports, high prices for grain imports because of a poor grain harvest in the region, and rapid growth in imports of consumer and investment

¹⁷⁵ The IMF reported that it was the Government's objective to "shift agricultural production from cotton to grain" in order to achieve this. Uzbekistan's output of wheat did increase to 3.5 million tons by 1998, but the production of raw cotton did not decrease (IMF, 2000, p. 41). The production of raw cotton was 3.6 million tons in 1999, and 3.2 million tons in 2001 (CIS Statistical Yearbook, 2002, p. 666).

goods (which) put pressure on the balance of payments...” (IMF, 1997b, p. 6).

This led the authorities to implement restrictions on imports and access to foreign exchange in mid 1996, in order to protect the foreign exchange reserves in the country (IMF, 1997b, p. 6).

In January 1997, Uzbekistan implemented an institutionalized multiple exchange rate regime (MER) (EBRD, 1997, p. 212). A primary purpose of this type of exchange rate system was to use “...an overvalued official exchange rate to tax exporting sectors (largely cotton and gold production) in order to subsidize imports of capital and priority consumer goods” (IMF, 2000, p. 7). The world price of cotton and gold had been going down from 1995 prices, which resulted in a decrease of revenue for the state (see Table 6.5, and CBR Commodity Yearbook, 2003, p. 66; p. 112). Therefore, the government needed a way to bring in additional revenue. This type of exchange rate system was also a mechanism by which the Uzbek government could improve the balance of payments situation by having more control over the country’s imports of consumer goods (Trushin, 1997, p. 216). This allowed the state to have enough currency reserves to pay for imports that were more important, such as equipment needed for the self-sufficiency of local industry.¹⁷⁶

The difference among the three exchange rates was dependent upon the purpose of the transaction. The “official” rate was established through a system of administrative transactions, including the exchange of proceeds from exports

¹⁷⁶ Interview, Official from the Embassy of Uzbekistan (July 11, 2002). Karimov had also made statements such as the statement that “Snickers bars” were not contributing to the benefit of Uzbek society, and that the import of consumer goods should be limited (Anonymous interview, July 11, 2002).

that were required for turnover to the government. The “auction rate” was used for transactions that were allowed access to foreign exchange such as some imported inputs and investment goods. A separate commercial rate was used for the imports of specific consumer goods and services, and finally the foreign exchange bureau of eligible banks for transactions with individuals used a cash market rate. The number of banks eligible for these types of transactions was reduced in 1997 from fourteen to two (EBRD, 1997, p. 212). An illegal (black) market for foreign exchange also expanded, with the difference between the illegal market and the official rate widening considerably from 100 percent in 1997, to more than 400 percent by late 1999 (IMF, 2000, p. 7). The basic purpose of the MER regime was to give the government control over the economic situation in the country. The plan of the Uzbek government was to exert more control over the economy, to make up for declines in the country’s terms of trade.

In November 1996, the IMF suspended the rest of the installments of the SBA due to the continuation of the MER, and the allocation of too much financial support to the agricultural sector. The goals for the economic program developed by the Uzbek authorities for the SBA included objectives such as “reducing administrative interventions in the economy” and in the area of structural reform, objectives included “further disengagement of the Government in economic activity” (IMF Press Release, No. 95/67). Any negotiations that the Uzbek authorities may have had with the IMF are not public information. However, in an interview with an IMF economist who was very familiar with the

situation, the interviewee stated that if the Uzbek government had consulted with the IMF regarding the balance of payments situation, that the IMF could have negotiated with them. Instead, the Uzbek government broke the performance criteria agreed upon, and the Fund had no option but to suspend the SBA.¹⁷⁷

The implementation of an explicit MER, and its continuation until October 2003, was continually cited as one of the most damaging decisions for the economic situation in Uzbekistan.¹⁷⁸ The Uzbek government had stated that it would phase out the state order system and production targets for cotton and wheat by 1998; however this action was delayed and production targets were still in effect at the district level in 1998 (Csaki and Nash 1998, p. 119). In a later assessment by the World Bank on the status of agricultural policy reform, Uzbekistan and Turkmenistan were stated to have reformed the least of the other CIS countries (Csaki and Tuck, 2000, p. vii).

The Uzbek government is very dependent on the agricultural sector, and specifically on the income from cotton exports, for most of its revenue. The government has also delayed reform in this sector, and had continued to have significant control over foreign trade through the MER system. Therefore, one reason for the government's involvement in the sector is due the governments' reliance on the agricultural sector for revenue.

One of the goals of this chapter was to examine the role of the continuity of elite in the economic reform process of Uzbekistan. Specifically, that a low turnover of the former Soviet elite would result in a delay of reforms. Numerous

¹⁷⁷ Interview, IMF economist, July 8, 2002.

¹⁷⁸ Interview, IMF economists, July 9, 2002; Interview, World Bank economist, July 10, 2002.

members of the early Uzbek government have remained as government officials through the late 1990's. As stated previously, many of these officials reappeared in the Uzbek government for 1994. Table 6.6 represents the continuity of important officials in the Uzbek government.

Table 6.6 Chronology of Important Uzbek State and Government Officials

Title	First Name	Last Name	First Year / Last Year in Government	In 2003 Uzbek Government?
Chmn. Oliy Majlis	Erkin	Khalilov	1994	Yes
Prime Minister	Utkir	Sultanov	1992	Yes
First Deputy Prime Minister, Minister of Agriculture, Water Utilization	Ismoil	Dzhurabekov	1992/Nov. 1998	No
Minister of Macroeconomics and Statistics	Bakhtyar	Khamidov	1992/July 2000	No
Minister of Foreign Economic Relations*	Elyor	Ghaniyev	Jan. 1998	Yes
Chrmn. National Bank for Foreign Economic Activity	Rustam	Azimov	Jan. 1998	Yes
Chrm. State Bank	Fayzulla	Mullajanov	Oct. 1995	Yes
Minister of Labor	Oqiljon	Obidov	Oct. 1995	Yes

Source: Russia and Eurasia FFA, various years;
http://uzland.narod.ru/gov_staf.htm

The fact that there are individuals from the early 1992 Uzbek government who had continued as governmental officials into the late 1990's and into the government listed for June 2003 is a strong indicator of the continuity of some of the former Soviet elite.¹⁷⁹ It would appear that I. Dzhurabekov, B. Khamidov and U. Sultanov had likely been the most influential in the Uzbek government due to their longevity. In a further indicator of at least one of these officials continuing from Rashidov's days, I. Dzhurabekov, was listed as a previous member of the

¹⁷⁹ Table 6.6 presents this in its most compact form, but the information provided previously in this chapter should also be considered in analyzing the former Soviet elite.

Rashidov government, specifically in the position of agricultural vice prime minister.¹⁸⁰ So why were I. Dzhurabekov and B. Hamidov both gone from the government at roughly the same time when they were obviously influential members of the former Soviet elite?

The reason is most likely related to the continuing drop in the target amounts from the cotton harvest. In November 1998, the Projections and Statistics Committee projected that the cotton harvest would again fall below the targeted amounts; at least twelve percent below the targeted amount.¹⁸¹ The cotton harvest target had also been missed the previous year by almost ten percent.¹⁸² Both of these men had been appointed to positions described as very important in the Uzbek government, but as has been noted, Karimov often shifts or removes persons in the government based on economic performance.

I. Jurabekov resigned his position as First Deputy Prime Minister and as Minister of Agriculture and Water Utilization on November 4, 1998, most probably as a result of the poor cotton harvest.¹⁸³ B. Hamidov was reported as being appointed the new governor of the Kashkadarya region on July 28, 2000.¹⁸⁴ It was reported that Karimov himself attended this session, and that he made a personal speech.¹⁸⁵ B. Hamidov was probably not re-assigned to this position by coincidence. Karimov held the position of First Party Secretary of the Kashkadarya oblast, prior to being appointed the First Secretary of the Uzbek

¹⁸⁰ Moscow, *Nezavisimaya Gazeta*, in Russian, June 28, 1994, p. 3; in FBIS, June 29, 1994, p. 55.

¹⁸¹ Russia and Eurasia, FFA, 1999, p. 424.

¹⁸² *Ibid.*,

¹⁸³ http://uzland.narod.ru/gov_staf.htm

¹⁸⁴ http://uzland.narod.ru/2000/08_05.htm

¹⁸⁵ *Ibid.*, The report noted that the session considered a "personal matter" and that the region's governor was released from his position at his request

Communist Party. This oblast was previously described by Carlisle (1995) as a “backwater region” (p. 196). Therefore, it was likely that B. Hamidov was being demoted as a result of the continuing poor cotton harvest. These actions again emphasize the importance of the production, and the sale of cotton for the state.

Kazakhstan

As explained in the section on early reform measures of Kazakhstan, there was a constant conflictual relationship between Nazarbayev’s government and the parliament on the implementation of economic reform. Due to the ruling by the Constitutional Court that the parliamentary elections held in March 1994, were invalid, Nazarbayev ruled by presidential decree from March 1995, until new parliamentary elections were held on December 5th and 9th of 1995 (Freedom House, 1998, p. 312). During this time period, Nazarbayev would initiate changes in two important areas regarding reform; one political and one economic. The area of political reform would be the adoption of a new constitution by referendum. The area of economic reform would involve the numerous presidential decrees (having the force of law) and economic reform measures issued during this period.

The new constitution was passed on August 30, 1995, with estimates that 89 percent of the electorate voted in favor of the referendum.¹⁸⁶ Nazarbayev had stated many times that he was unhappy with the power wielded by the parliamentary system of government, and that Kazakhstan needed constitutional reforms.¹⁸⁷ Therefore, the new constitution provides for the majority of the power

¹⁸⁶ *Kommersant-Daily*, September 1, 1995, p. 3; in CDPSP, Vol. XLVII, No. 35, p. 24.

¹⁸⁷ See the previous statements by Nazarbayev in this chapter.

to reside in the presidency, in a presidential form of government. Also, the sections of the new constitution that had the most changes were the sections outlining the new smaller two-chamber structure of the parliament. The new constitution would allow for 102 total deputies, whereas the previous two parliaments had 350 and 178, respectively.¹⁸⁸

During the discussion stages of the Constitution, not all Kazakhs were in favor of the increased role of the president. In fact, members of the Constitutional Court had sent Nazarbayev a letter explaining their belief that parts of it were “undemocratic.”¹⁸⁹ The new constitution would allow Nazarbayev to have more control over the parliament, and more control over the structure of the government. However, it also appears that Nazarbayev was working to form a more compliant parliament and government that would allow him to proceed with economic reforms in the manner that he wished.

Therefore, this new elite was likely formed at least in part due to their support for Nazarbayev about his economic reform program. An example of the manner by which government officials were chosen is illustrated by the position that Marat Ospanov occupied after he wrote an article titled “Why I Accept the New Constitution.”¹⁹⁰ Ospanov was in the previous parliament, and had been involved in the drafting of the previous constitution of January 1993. In the article

¹⁸⁸ *Kommersant-Daily*, July 6, 1995, p. 4; in CDPSP, Vol. XLVII, No. 27, p. 21; and in the Constitution of Kazakhstan, Section IV Parliament.

¹⁸⁹ *Sevodnya*, July 22, 1995, p. 4; in CDPSP, Vol. XLVII, No. 29, p. 20. The author also pointed out the irony that it was the decision by the Constitutional Court that allowed Nazarbayev to dissolve the parliament in March in the first place.

¹⁹⁰ *Almaty, Kazakhstanskaya Pravda*, in Russian, August 16, 1995, p. 2; in FBIS, August 28, 1995, p. 67-70.

he defended the new constitution, and indirectly the decision by Nazarbayev to rule without the “politicians” in parliament because

...the tactics of economic reform were the stumbling blocks for the politicians of Kazakhstan who classify themselves as democrats. Criticizing the measures pertaining to macroeconomic stabilization and their primacy in relation to microeconomic transformations, they are, in fact, going against the pivot of any democracy – market relations.¹⁹¹

M. Ospanov was then appointed as the Chair of Foreign Investment in the October 1995 Kazakh government, a position he was likely appointed to given his views on economic reform, as well as the fact that he was an economist. As early as 1991, Nazarbayev had brought in western economists to hear their advice on economic reform, and privatization. Nazarbayev explained the importance of their advice by stating that

The Western scientists are not simply economists, the market is their natural element, and I value their recommendations.¹⁹²

Nazarbayev’s decision to bring in economists, and to develop a new, younger group of reformers was stated as very important for Kazakhstan’s approach to economic reform.¹⁹³

¹⁹¹ Ibid.,

¹⁹² Moscow, *Komsomokskaya Pravda*, in Russian, April 13, 1991, p. 2; in FBIS, April 18, 1991, pp. 54-59.

¹⁹³ Interview, World Bank economist, July 12, 2002; Interview, IMF economist, July 8, 2002.

Numerous laws that were passed during 1995 greatly advanced the economic reform program of Kazakhstan.¹⁹⁴ In fact, due to the country's economic reform program envisioned for 1996-1998 the IMF approved a three-year Extended Fund Facility (EFF) for Kazakhstan in July 1996. In this IMF Press Release, it was noted that

1995 was the most successful year for the Kazakh economy since independence. Under the authorities' program, supported by a stand-by credit from the IMF, inflation was reduced significantly, and the balance of payments performed consistently better than expected. Progress was made in privatization and public enterprise restructuring and, and the decline in output began to level off.¹⁹⁵

The Kazakh ambassador to Moscow also noted that the president was able to produce more than fifty pieces of legislation during the three months after the dissolving of the parliament; compared with seven laws passed during the year long tenure of the March 1994 parliament.¹⁹⁶ The major areas of legislation implemented during this time period, the dates, and a brief description of the legislation is compiled in Table 6.7.

¹⁹⁴ At a symposium titled "Rule of Law in Kazakhstan: How Much Change?", sponsored by the Central Asia-Caucasus Institute of Johns Hopkins University, Mr. I Rogov, the Deputy Chief of the Administration of the President of the Republic of Kazakhstan, stated during his speech that the market economy in Kazakhstan was helped by legislation passed in the early years of the republic, including the 1995 constitution. When I asked him if he was referring to all of the legislation passed in 1995 as well, he stated that he was referring to the Civil Code part of the 1995 Constitution, which he stated was similar to an economic constitution of the country (Washington, D.C. September 17, 2003; moderated by Frederick Starr).

¹⁹⁵ IMF Press Release, No. 96/39, July 17, 1996.

¹⁹⁶ *Kommersant-Daily*, July 6, 1995, p. 4; in CDPSP, Vol. XLVII, No. 27, p. 21.

Table 6.7 Significant Legislation Implemented After the Disbanding of the March 1995 Parliament.

Date	Legislation	Description
April 1995	Establishment of the Rehabilitation Bank	With the coordination of the World Bank. The purpose of the bank is to control the financial transactions of enterprises and to be their only source of credit. While the bank is funded from the state budget, it is intended to operated independently from the state under the direction of a Board.*
June 1995	Compulsory Medical Insurance Fund	The purpose of the Fund is to provide universal medical coverage. It would become effective in January 1996
July 1995	Revised Budget	This budget supersedes the budget passed by parliament in March 1995. The revised budget kept the previous deficit target for the year, but revised revenue and expenditure expectations, due to changes in the new Tax Code.
July 1995	Tax Code	This code was a major improvement to the tax system and was representative of systematic laws adhering to international standards. The number of taxes was reduced from 49 to 11.
August 1995**	Banking Legislation	Separates investment banks from deposit-taking banks. The idea was to first establish proper accounting methods and then liberalize the activities of banks.

Source: IMF 1995, p. 21; IMF 1996, p. 17, 23, 27; EBRD 1996, pp. 156-157; EBRD 1997, p. 177.

*A Bankruptcy Law was passed in April 1995; the effectiveness of which would influence the progress of the Rehabilitation Bank (EBRD, 1995, p. 45).

**Also in August of 1995, a previous fifty percent requirement for exports proceeds was abolished.

Kazakhstan also made progress in the area of currency convertibility and the exchange rate regime during this time period. A condition of Kazakhstan's acceptance of the Extended Funding Facility (EFF) from the IMF was that the

county agreed to end any practice of restricting current account transactions, as well as an agreement not to implement discriminatory currency arrangements.¹⁹⁷ Progress was also made in the agricultural sector. In 1995, the Kazakh government eliminated the “state needs” system for grain, and introduced a market determined system, including the elimination of administered prices in the agricultural sector (IMF, 1996, p. 19). Kazakhstan was also progressing in its small-scale privatization program, with about 70 percent of the total eligible firms (with less than 200 employees) being sold by early 1996 (EBRD, 1996, p. 156). The privatization of large enterprises concentrated in the power, energy, and communications sectors continued through 1996 and into 1997, and resulted in “considerable foreign investment” (EBRD, 1997, p. 176).

Kazakhstan has implemented some of the broadest reforms of all the Central Asian states.¹⁹⁸ The acceptance of Article VIII obligations and the decision to have complete convertibility of the currency was continually cited as one of the most important steps for the economic reform process in Kazakhstan.¹⁹⁹ However, many of these broad reforms were implemented during presidential rule and without the noncompliant parliaments, and officials that had blocked reform measures. Nazarbayev has used his presidential authority to bring into the government a new elite group, and one that supports his economic reforms.²⁰⁰

¹⁹⁷ Articles of Agreement of the International Monetary Fund, Article VIII, Sections 2 and 3.

¹⁹⁸ Personal conversation, IMF economist, September 5, 2001.

¹⁹⁹ Interview, IMF economist, July 9, 2002; Interview, IMF economist, July 8, 2002.

²⁰⁰ Olcott (2002) has pointed out that many firms and companies are allegedly controlled by or owned by persons that are close to Nazarbayev, or are members of his extended family (in this publication see Appendix 12, pp. 264-267).

One of the goals of this chapter was to examine the high turnover of the former Soviet elite in the economic reform process of Kazakhstan. There are no members of the early Kazakh government that have remained as government officials into the 1990's. The fact that there are no members from the early 1992 Kazakh government that have continued in the government listed for June 2003, is a strong indicator of the high turnover of the former Soviet elite.²⁰¹ Instead, there has been a pattern of a shift in the government with the disbanding of the two parliaments and Nazarbayev's belief that many of the governmental officials were not proceeding with economic reform as he envisioned. Olcott (1997) pointed out that this pattern of changes in the parliamentarians was evident with her statement that

An undeniable, if less broadcast, dimension of the deputies' opposition to economic reform has been that privatization (has) shift(ed) economic advantage away from the Soviet-era elite, the nomenklatura, to a new elite. (p. 224)

Nazarbayev has replaced his opponents with officials who support his ideas about economic reform. This is a fundamental difference between the presidents in the two countries. Karimov has delayed economic reform, and has been responsible for a low turnover of the former Soviet elite. Nazarbayev has supported reform and has been responsible for a high turnover of the former Soviet elite.

²⁰¹ Information on the June 2003 Kazakh government officials found at http://us.poltinco.com/Information/Government_Officials/government_officials_91.html

Conclusion

This chapter has shown that an analysis of the relationship between the president and their actions concerning the former Soviet elite are crucial in understanding each country's progress on economic reforms. More importantly, while each president was a member of the former Communist elite, they each embarked on divergent economic reform paths. These paths were due to differences in each president's view about economic reforms, and in the role of the president in the degree of turnover of the former communist elite.

The decisions by Nazarbayev to disband the parliament on two different occasions were actions intended to increase or consolidate his position as the president. However, this chapter has provided evidence that Nazarbayev's actions, at least in part, were a result of the decisions by the parliaments not to proceed with economic reforms. Karimov did not have this situation with his parliament because there was no apparent disagreement on his decision to proceed slowly with economic reforms, or to delay the reforms when the economic situation did not bring in needed revenue for the state.

The next chapter will analyze whether economic reforms, including foreign investment legislation, have influenced investment or business decisions in these two countries. Specifically, the chapter will examine whether the advanced economic reforms in Kazakhstan have influenced the high levels of investment/business into the country, and conversely, whether the delayed economic reforms in Uzbekistan have influenced the low levels of investment/business into the country.

Chapter 7: The Relationship Between Economic Reform and Foreign Investment/Business Decisions

The previous two chapters have provided evidence for understanding the differences in the economic reform paths of Kazakhstan and Uzbekistan. Chapter 5 described how the levels of integration during the Soviet era had influenced each country's level of international economic orientation. Chapter 6 illustrated how the influence of a strong president and the president's relationship with the elite strongly influenced the level of advancement of reforms in each country. This chapter will expand upon the previous analyses of economic reforms by examining whether the implementation of these reforms has influenced foreign investment or business decisions in either country.

First, the chapter will briefly review the main issues about investment and economic reform in the transition economies. Then the relationship between economic reform and investment will be analyzed based on the results of interviews with investor and business representatives conducted during September and October of 2003. The responses from the representatives interviewed will be categorized according to whether the firm had direct investment in the countries (natural resources firms); whether the firm was contracted by a natural resource firm (services firms); or whether the firm had business involvement with the countries (business firms). The categorization of the responses in this format was necessary for two reasons. First, it was not anticipated at the onset of the project that representatives would agree to be

interviewed only on the condition that they, as well as the firm that they represented, would not be named in this chapter. Therefore, some of the stronger results from the interviewees could not be included in the analysis if the identity of the firm could be determined from the disclosure of the information. That is why, for example, that firms with investment for natural resource were not organized to reflect investment in the specific countries.

Second, after careful analysis of the data it was determined that this type of categorization was the most illustrative of the differences in the degree and types of economic reforms that representatives considered to be the most important in their investment/business decisions. Therefore, the use of tables to categorize these results is meant to be organizational and to illustrate the varied responses of the interviewees. All of the firms that were selected to be included in the study fit the criteria of the study; that each firm either had investment or had conducted business in one or both of the case study countries. Given the reality of few major firms that fit these criteria, this is a sufficient sample to be able draw conclusions about whether economic reforms were a consideration for a firms' decision to invest or conduct business in Kazakhstan and Uzbekistan.

These interviews with investor and business representatives will determine whether there is a relationship between the advanced economic reforms of Kazakhstan and its large investment levels; and whether the delayed economic reforms of Uzbekistan, and specifically the MER regime, have influenced the small investment levels. Specifically, these interviews will determine (a) if there is a relationship between economic reform and foreign

direct investment for natural resources (b) if representatives considered economic reforms in their decision to conduct business in either country and (c) which of the four indicators of economic reform (foreign investment laws; progress on privatization, legislation; reform measures undertaken in the sector of investment and; reform in the trade liberalization/foreign exchange system) was the most important in determining investment or business decisions. The chapter will conclude with a comparison of each country's progress on the economic reform indicators deemed most important by investor and business representatives.

Issues Concerning Foreign Investment

There is much research on economic reform and foreign direct investment into the Central and Eastern European states.²⁰² Meyer (1998) investigated firms' decisions about direct foreign investment in the Central and Eastern European states. He found that the greatest differences in direct foreign investment were between Central Europe and the countries of Russia and Romania. He stated that this was due in large part to the slower progress on economic reform in the latter countries (Meyer 1998). Michalet (1997) additionally analyzed criteria that explain why firms chose the countries in which to invest and looked at different investment strategies of firms investing in Central and Eastern European countries.

²⁰² The researchers listed usually include Russia in their analysis, but not the other former Soviet republics. Research that includes the fSU republics will follow this section.

One of his findings was that countries wanting to enact policies to promote foreign investment should have in place

a stable political and economic climate, and a transparent and non-discretionary legal and regulatory framework. (Michalet, 1997, p. 3)

He further noted that countries that did not have these policies were excluded from the “core” countries that investors had ranked as places that they would want to invest.

These findings are likely to be similar in an analysis of investment in the fSU republics. However, there is only a small amount of research concerning investment or business into the fSU. Most notably the research is lacking in concrete information about which areas of economic reform influenced investors' decisions to invest, or to do business in these countries. The relatively small amount of research about FDI in the fSU states also likely results from the small amounts of FDI into those countries, and to the poor data collection of many of those states.²⁰³ Meyer and Pind (1999) find that foreign direct investment amounts to the fSU countries are determined by; degree of advancement in the transition, whether the country is resource rich; and degree of reform implementation. However their research did not use indicators to measure degrees of advancement, or degree of reform implementation. Additionally, they find that Azerbaijan, Turkmenistan and Kazakhstan's “strong position” in FDI amounts is due to its natural resources (Meyer and Pind, 1999, pp. 206; 211).

²⁰³ Meyer and Pind, 1999; this has been noted in the case of Uzbekistan. Officials that I spoke with would often refer to a firms' involvement with the country as foreign direct investment. The firm's representative would then clarify that they had done business with the country, but did not have direct investment.

They additionally stated that the “less reform-orientated” countries of Belarus and Uzbekistan had received little FDI thus far (p. 212). However, Turkmenistan ranked as the country that had implemented the least economic reforms of all the Central Asian states in an interview with IMF economists.²⁰⁴ Which leads to the question as to whether there is a clear relationship between reforms and natural resources.

Jones-Luong and Weinthal (2001) examined different development strategies pursued by five of the energy-rich former Soviet republics.²⁰⁵ They argue that a main difference in the development strategies pursued by Uzbekistan and Kazakhstan is that Uzbekistan “...rejected the direct involvement of international actors” in its energy sector, while Kazakhstan actively engaged foreign investors in the energy sector (Jones-Luong and Weinthal, 2001, p. 639). However, they do not consider that a country’s implementation of economic reform is likely an important consideration for foreign investors to invest in this sector, and that Uzbekistan’s delay in economic reform may have deterred investors. Shiells’ (2003) recent paper on FDI and the investment climate in the CIS used the responses from IMF country teams to identify factors that had affected the business environment in these countries. He concludes from these interviews that investment has been hindered by a lack of structural reforms including: issues of corruption, weak legal frameworks and difficult tax systems. Therefore, more information is needed about whether investors consider economic reforms in their decisions to invest for natural resources; as well as

²⁰⁴ Interview, IMF economists, July 9, 2002.

²⁰⁵ The countries they examined are the Russian Federation, Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan (Jones-Luong and Weinthal, 2001).

whether they consider economic reforms in their decisions to conduct business in the fSU republics.

Moran (1998; 1999) has looked extensively at foreign direct investment, and (1999) specifically at issues concerning investment for natural resources and economies in transition. Moran (1999) explained that this type of investment is different because there are more exposure risks involved in long-term projects.²⁰⁶ For many of these types of projects the firm has already invested in infrastructure that cannot then be easily withdrawn. Moran explains that (1999, p. 143)

FDI in natural-resource projects are more exposed to this “structural vulnerability” than are investors in other sectors. They must make large lump-sum investments that require payment of a high risk premium long after the initial risk and uncertainty have dissipated.

Stern (1995) additionally noted that some firms had become more reluctant to become involved in the big exploration projects for oil and gas specifically in the CIS countries due to the “substantial up-front capital investments” (p. 14). Van Meurs (1971) explained that petroleum exploration is a “most risky business” also due to the large amounts of money required at the beginning, and that specific economic risks included the potential for change in future tax structures (pp. 64-66). Meier (1995) cited similar risks to foreign investors that included “changes in taxation, foreign-exchange remittance restrictions... and changes in tariffs and quotas” (p. 262). Furthermore, these types of policy changes often do not involve issues of nationalization or seizing of property but are “firm-specific or even project-specific” (Meier, 1995, p. 262).

²⁰⁶ Moran noted that some areas of risk included nationalistic actions on the part of the host government; which most often occurred in the mining and petroleum sectors (1999, p. 141).

Investors would then be concerned about the security of their investments, as well as changes in contracts once the projects were underway. Therefore, it is very likely that investors would look at economic reform issues when considering investment for this sector in Kazakhstan and Uzbekistan. This is important because some scholars have argued that the presence of oil may often override an analysis of economic reform considerations.²⁰⁷ Interviews with investor representatives that have invested in Kazakhstan's oil and gas sector will provide information about whether Kazakhstan's economic reform was a factor in their decision to invest in that natural resources sector. While Uzbekistan does not have the amount of proven oil reserves of Kazakhstan, the country did have some projects and interest in the oil and gas sector, as well as investment in its non-ferrous metals sector. Each country has also had firms that have conducted business in both countries in sectors such as agricultural, consumer goods, aerospace, and mining.

Firms with Investment for Natural Resources: Including Services Firms

The results from Table 7.1 indicate a number of trends about investment for natural resources.

²⁰⁷ Ebel and Menon, 2000; Karl, 2000; Interview, Consultants, DRI-WEFA (formerly Plan Econ), July 11, 2002.

Table 7.1 Firms with Investment for Natural Resources: Including Services Firms (eleven firms).

Question	Yes	No	Other
1. Did the country's implementation of economic reform influence the investment decision?	3	5	(3) Go where client goes; Went in with another firm.
2. Does the value of this natural resource override an analysis of areas of economic reform in the country?	2	5	(1) Yes and No (1) If big risk can firm get paid more? (2) Go if big firms are there (services).
3. Was there an aspect of economic reform that influenced the decision to invest in this sector?	7	4	

First, there seems to be a disconnect between representatives' answers to question (1) and question (3); considering that the questions were theoretically designed assuming that the questions would be answered in the same manner. If a representative stated that a country's implementation of economic reform did not influence the investment decision, it was deemed likely that that same representative would then answer that there were no aspects of economic reform that influenced the investment decision.²⁰⁸

Five representatives stated that a country's implementation of economic reform did not influence the investment decision, and only three stated that it did. However, when asked if there was an aspect of economic reform that influenced the decision by the firm to invest in a particular sector, seven representatives stated that there was and four stated that there was not. This disconnect between what could be viewed as essentially similar questions was seen

²⁰⁸ Question (1) was asked before question (3) in all of the interviews. The first question asked in the interviews was "What was the primary reason for the investment/business decision into Kazakhstan/Uzbekistan" in order to clarify whether the firms involvement was for investment or business, and to clarify what area or sector the business or investment was for (see Appendix A).

throughout the analysis of the respondents whether the firm's involvement with the country was for direct investment or for business.²⁰⁹

The discrepancy is between what representatives understand when they are asked a *general question* about whether a country's implementation of economic reform influences the business or investment decision; and then when they are asked if there is an *aspect* of economic reform that influenced the decision to invest or conduct business in a particular sector. In an interview with a business associate, the associate explained the discrepancy by stating that

Representatives likely define economic reform as the overall macroeconomic reform process. They view this term as indicative of the governments overall strategy of reform, and that the representatives think that I am asking if the broad overall economic political reform was important.²¹⁰

The associate additionally stated that difference in the answers to questions (1) and (3) is explained by the fact that

...the firm is only interested in the specific areas or sectors that matter to their investment.²¹¹

The second trend identified is that only two representatives out of eleven stated definitively that the value of the natural resource did override an analysis of economic reform in the country (question 2). Two representatives of services firms stated that this question was not relevant to them because the bigger firms that had direct investment interests would contract them for service purposes.

²⁰⁹ The analysis of the responses of representatives of business firms will be summarized later in this chapter. However, of the ten representatives of business firms, only one stated that the firm did not use country risk assessments, and one representative stated only that the firm was aware of them.

²¹⁰ Anonymous Interview, October 30, 2003.

²¹¹ Ibid.,

After careful analysis, the results from this table indicated that representatives of firms that had been contracted for services and engineering purposes often gave different answers concerning a relationship between economic reform and investment than firms that had direct investment for natural resources. As evidenced by the answers given in the "other" column for answers to questions (1) and (2), the representatives often stated that they were in the countries because the "big firms were there." Therefore, in order to obtain a clearer understanding of the relationship between direct foreign investment and economic reform, an additional table is necessary that only includes the responses of representatives that have invested in the countries for natural resources, and excludes services and engineering firms.

It would also be necessary to separate these firms to determine if the answers to question (3) would have similar responses once the services firms were removed. This would also determine if the firms with direct investment for natural resources still considered economic reform analysis in their investment decisions, or if the value of the natural resource would override these considerations

Excluding Services Firms

The separating of firms based on whether their involvement with the countries was as a result of direct investment indicates that there is a difference in their responses to the influence of economic reforms on investment decisions into the countries. The most striking difference in the results is the answers to question (3) (see Table 7.2a).

Table 7.2a Firms with Investment for Natural Resources: No Services Firms (seven firms).

Question	Yes	No	Other
1. Did the country's implementation of economic reform influence the investment decision?	3	4	
2. Does the value of this natural resource override an analysis of areas of economic reform in the country?	1	4	(1)Yes and No (1)If big risk can firm get paid more?
3. Was there an aspect of economic reform that influenced the decision to invest in this sector?	6	1	

In the previous responses, four representatives stated that there was no aspect of economic reform that influenced the decision to invest in a particular sector (see Table 7.1). All but one of these representatives were from services firms; six out of seven representatives from natural resources firms stated that there was an aspect of economic reform that influenced the investment decision (see Table 6.2a). It is also important to note that the only representative who answered "no" to question (3) was also the only representative to answer question (2) definitively that the value of the natural resource did override an analysis of economic reform in the country. The specific areas of economic reform that representatives of direct investing firms stated as influencing their investment decisions are presented in Table 7.2b.

Table 7.2b Areas of Economic Reform that Influenced the Investment Decision: Firms with Investment for Natural Resources (seven firms).

Area of Reform	Number of Representatives that gave this Answer
Sanctity of the Contract, Contract Laws	3
Foreign Investment Laws, Production Sharing Agreements (PSA's)	2
Transparency of Laws	1

The most important areas of economic reform for the investment decision were issues concerning the sanctity of the contract and issues concerning foreign investment laws (see Table 7.2b). Due to the small number of firms having direct investment in natural resources in Uzbekistan, it is not possible to develop separate tables based on the number of firms investing in Kazakhstan and Uzbekistan. However, there was one representative who stated that it was likely that the firm may have looked into the oil and gas sector in Uzbekistan but that the firm “walked or ran away.”²¹² When I asked if the firm then considered Kazakhstan to be a more stable environment for the firms’ investment than Uzbekistan, the representative responded that, “actions speak louder than words.”²¹³ There was also a representative of a services firm who stated that the firm had been involved in projects concerning natural resources in Uzbekistan, but that “the internal decision process did not work out” and that “the project closed down.”²¹⁴ This was all of the information that the representative provided about the project. Therefore, it is likely that one reason for Uzbekistan’s low level

²¹² Interview, Representative of a Natural Resources Firm, September 23(b), 2003.

²¹³ Ibid.,

²¹⁴ Interview, Representative of a Services Firm, September 23(a), 2003.

of investment has to do with its lack of reform in areas that representatives stated were important for the investing decision.

The difference between the types of firms (natural resources and services) and their views on the importance of economic reforms for an investment decision depended on the differences of the assessment of risk that was involved between the two types of firms. Representatives of the services firms often stated that their risk, and therefore their focus on the economic reforms implemented in a particular sector was minimal. The reasons that the representatives stated that the assessment of risk was different than that of the direct investment firms included:

- (1) A smaller time horizon of three-four years for their firms' involvement as opposed to ten plus years for direct investing firms.
- (2) That economic reforms were not a consideration because;
 - (a) These firms assume that the bigger firms wouldn't be in a country in the first place if there were serious risks involved.
 - (b) The bigger firms would deal with those issues; and that therefore
 - (c) there was more of an emphasis on where the client goes.
 - (d) The contracts with the direct investing firms stipulated that the services firms would get paid immediately, often before the contract would begin. The only risk would be that personnel would have to be relocated.²¹⁵

Therefore, the services firms were not exposed to the same type of risk as the investing firms, which were the types of risks discussed by Moran (1999); Van Meurs (1971) and Meier (1995). Other ways that firms mitigate risk are evident in the analysis of the results from the representatives that conducted business in both countries.

²¹⁵ Interviews, Representatives of Services firms, September-October 2003.

Firms with Business Involvement

The next table includes a categorization of the answers concerning whether representatives of business firms considered economic reform in their business decisions (see Table 7.3).

Table 7.3 Firms with Business Involvement (ten firms).²¹⁶

Question	Yes	No	Other
1. Did the country's implementation of economic reform influence the investment decision?	5	5	
2. Was there an aspect of economic reform that influenced the decision to conduct business in this sector?	8	2	
2a. Was the aspect related to EXIM Bank financing?	4	4	1) A foreign financing bank similar to EXIM Bank was used.
2b. Was EXIM Bank used to provide financing for the business?	5	4	1) A foreign financing bank similar to EXIM Bank was used.
For Kazakhstan?	1		
For Uzbekistan?	3		1) A foreign financing bank similar to EXIM Bank was used.
For both?	1		

The aspects of Export-Import Bank (EXIM Bank) financing were not listed in the questionnaire, and instead its importance was determined by an analysis of the respondents' answers to question (2).²¹⁷ A large number (eight out of 10) of representatives answered that there was an area of economic reform that

²¹⁶ There was only one firm that had conducted business in Kazakhstan, but not in Uzbekistan. The differences between the firms primarily had to do with whether non-private banking finance was used to supplement the business.

²¹⁷ One of the benefits of doing focused personal interviews, as well as asking open-ended questions is that respondents often lead the researcher into new important areas, that the researcher was not aware were important.

influenced the business decision (see Table 7.3; question (2)). Additionally, when the representatives expanded upon their answers, five out of eight representatives stated that the area of economic reform was related to financing by the EXIM Bank, with one additional representative stating that the firm used a foreign financing bank similar to the EXIM Bank (see Table 7.3; the “other” column for the answer to questions (2a) and (2b)). The following section explains the purpose of the EXIM Bank and how firms used the Bank to mitigate their risk primarily for conducting business in Uzbekistan.

The Export-Import Bank

The EXIM Bank was created to increase US trade and to provide financing that is not provided by the private financing sector. Therefore, the EXIM Bank

... does not compete with private sector lenders but provides export financing products that fill gaps in trade financing. (the Bank) assume(s) credit and country risks that the private sector is unable or unwilling to accept.²¹⁸

The Bank functions in a way as a lender of last resort, although the purpose of the Bank to function in this manner is a topic of considerable debate.²¹⁹

Therefore, while the Bank is to assume some risk that the private financing will not, the Bank is expected to lend “only when there is a reasonable assurance of repayment” and not to go below “a minimum level of creditworthiness”

(Rodriguez, 2001, p. 6).²²⁰

²¹⁸ See the mission statement of the Bank at <http://www.exim.gov/about/mission.html>

²¹⁹ See the chapters in Hufbauer and Rodriguez, 2001.

²²⁰ Interview, EXIM Bank economist, October 3, 2003.

The Bank determines a country's creditworthiness and risk and then determines whether the Bank will lend on a sovereign (arranged with the state) or non-sovereign (arranged with private firms) basis.²²¹ Therefore, the Bank provides financing (or is "open") to a country on a short, medium or long term sovereign and/or non-sovereign basis that is determined by economic and political criteria. Sovereign lending is arranged only with a government (no private firms) and is the least risky.²²² Considerations for this type of arrangement include: the volatility of the political system; the re-payment history of the country; debt burden; balance of payments situation; and the macroeconomic situation. Non-sovereign lending is arranged with private firms and therefore is more risky. Considerations for this type of arrangement include: volatility of the political system; vulnerability to foreign exchange crisis; banking legal system; available foreign exchange; and the general business climate.²²³

The EXIM Bank is open in sovereign and non-sovereign lending in Kazakhstan. Kazakhstan was also the first of the Newly Independent States (NIS) to be open across the board in the private sector, for short, medium, and long-term arrangements.²²⁴ This is important because it indicates that the Bank assessed that the private sector in Kazakhstan was creditworthy for the Bank to support financing in that sector. Uzbekistan is only open in sovereign lending, for short and medium term arrangements, but not for long term. However,

²²¹ Information on EXIM Bank financing as well as the Bank's position regarding Kazakhstan and Uzbekistan was provided in an interview with an EXIM Bank economist (October 3, 2003).

²²² Sovereign lending is the least risky because the government signs a guarantee that the state will use all its resources to pay the loan; referred to as a "sovereign guarantee." Non-sovereign lending is with a private firm, and does not have this same type of guarantee from the state.

²²³ Interview, EXIM Bank economist, October 3, 2003.

²²⁴ *Ibid.*,

Uzbekistan also has a perfect re-payment record with the Bank, which means that the country never defaulted on a loan, and therefore has not had to make payments to the EXIM Bank. Therefore, while Uzbekistan has a lower rating from the Bank than does Kazakhstan (only open in short and medium term sovereign), it is in good standing, so to speak with the Bank.

Kazakhstan has less need for EXIM Bank financing because the country can receive commercial financing; it meets the criteria for risk in the private sector.²²⁵ This explains why firms used the EXIM Bank less for business with Kazakhstan. The representative of the firm that did use the Bank for financing with Kazakhstan does not have this type of business arrangement with Uzbekistan. The representative stated further that the Bank was used in this particular case due to the large amount of business in Kazakhstan.²²⁶ Four firms used the EXIM Bank for business only with Uzbekistan.²²⁷ The reasons that representatives stated that they used the EXIM Bank were

1. Bank sets up the financing, and takes the risk if the government doesn't pay.
2. The country's lack of reform was balanced by a sovereign guarantee.
3. Financing by the EXIM bank was crucial to the projects going forward (2 representatives stated this).²²⁸

These firms also had some manufacturing done domestically in the host countries. This included the employment of local workers, training programs and certification of factories for parts assembly. The EXIM Bank does require that

²²⁵ Interview, EXIM Bank economist, October 3, 2003.

²²⁶ Interview, Business representative, September 30, 2003.

²²⁷ One representative stated that the firm used the EXIM Bank for both countries for non-governmental projects (Interview, Business representative, September 26, 2003).

²²⁸ Interviews, Business representatives, September-October 2003.

80-85 percent of the product be manufactured in the US for the project to be financed by the Bank.²²⁹ These representatives also stated that developing local industry and employment were important aspects of business deals with the Uzbek government. So the involvement of the Bank benefited the host country (in this case primarily Uzbekistan) as well as the firm, and to a degree, US workers. The firm does have to pay a percentage of the loan for the Bank to be involved in the financing of the loan. However, representatives stated that if the Bank was willing to be involved that it was beneficial for the firm to be able to increase its business.

There were three representatives who stated that while there was an aspect of economic reform that influenced the decision of the firms to conduct business in a particular sector; the area of reform did not have to do with EXIM Bank financing, or a foreign financing bank (see questions 2, 2(a), Table 7.3).²³⁰ One representative of a firm that conducted business in both countries stated that areas of reform in Kazakhstan that influenced the business decision included “rule of law, the ability to freely exchange currency and the ability to repatriate foreign currency.”²³¹ This representative stated that economic conditions in Uzbekistan “were and still are difficult”, and that the non-convertibility of the currency, in addition to “general obstacles to doing business such as contract registration, import tariffs and excise duties” were some reasons for the smaller

²²⁹ Interview, EXIM Bank economist, October 3, 2003.

²³⁰ One representative stated that while the firm used EXIM Bank financing, that the financing was not related to an aspect of economic reform.

²³¹ Personal communication, Business representative, December 1, 2003.

level of business in the country.²³² One representative of a firm that also conducted a smaller level of business in Uzbekistan stated that economic reform areas that were important to the firm included “banking sector development and a legal base for commercial activities.”²³³ The third representative stated that the firm had only conducted business with Kazakhstan, and that economic reform areas included “the creditworthiness of the government, and the ability of the government to pay, whether in dollars or the country’s own currency.”²³⁴

Currency Convertibility

A question toward the end of the interviews asked each representative to rank the importance of the issue of currency convertibility for the investment/business decision. This question was deemed important for two reasons. First, it was one of the most obvious areas of difference between the two countries progress on economic reform.²³⁵ Second, the fact that Uzbekistan’s currency was not freely convertible was consistently cited as one of the reasons for the low levels of investment and business.²³⁶ The following analysis includes all three categories of firms whose representatives ranked the issue of currency convertibility. The responses of the representatives from services firms are included because many services firms pay employees in local currency.

²³² Ibid.,

²³³ Interview, Business representative, October 30, 2003.

²³⁴ Interview, Business representative, September 12, 2003.

²³⁵ See the discussion in Chapter 5 that reviews each country’s acceptance of Article VIII obligations, agreeing to full currency convertibility of the current account.

²³⁶ One economist stated that the issue of currency convertibility would need to be resolved even before investors would consider investing for natural resources (Interview, IMF economists, July 9(a), 2002).

The fact that representatives of direct investing firms ranked the issue of currency convertibility as least important to the investing decision is not surprising because their investment was for a natural resource that could be sold on the world market for dollars (see Table 7.4a).

Table 7.4a Firms with Investment for Natural Resources: Ranking of the Issue of Currency Convertibility (seven firms).

Scale of 1-10; (1 being the least important, 10 being the most important)

Currency Convertibility	Number of Representatives	Responses in Addition to a Ranking
Ranked CC a 1 or 2	4	(2) Contract stipulated payment in dollars.
Ranked CC a 4		
Ranked CC a 5 or 6	2	(1) Important because firm pays employees in local currency.
Ranked CC a 6 or 7	1	

Note: CC stands for Currency Convertibility

One representative who ranked currency convertibility as a 5 or 6 (with the understanding that "5" was the middle range) stated that it was important because the firm paid its local employees in the domestic currency. An additional representative who also paid local employees in the domestic currency, stated that the issue of the non-convertibility of the currency would not be enough to stop an agreement, that firms were "used to some risk" but that the ability to "negotiate a deal was the most important."²³⁷

Representatives of services firms also did not rank the issue of currency convertibility as important to their involvement with the countries (see Table 7.4b).

²³⁷ Interview, Representative of a Natural Resources Firm, September 30, 2003.

Table 7.4b. Services Firms: Ranking of Issue of Currency Convertibility (four firms). Scale of 1-10; (1 being the least important, 10 being the most important)

Currency Convertibility	Number of Representatives	Responses in Addition to a Ranking
Ranked CC a 1 or 2	3	
Ranked CC a 4		
Ranked CC a 5 or 6	1	(1) Employees paid in local currency

Note: CC stands for Currency Convertibility

This is somewhat surprising considering that most of the firms paid local employees in the domestic currency. However, the issue of problems with currency convertibility was not an important one to these firms. Primarily this is the case because these firms are paid immediately in dollars by the contracting firms (natural resources firms) when the contract is agreed upon.²³⁸ One representative stated that issues of currency convertibility “would factor into the decision, but that it was an obstacle that the firm could get around” often with the assistance of the contracting firms.²³⁹

Representatives of firms conducting business in the countries ranked the issue of currency convertibility as more important to the business decision than did the other categories of firms (see Table 7.4c).

²³⁸ Interview, Representatives of Services Firms (September, 10, 2003; September, 23a, 2003). Interview, Representative of a Natural Resources Firm, October 14, 2003.

²³⁹ Interviews conducted with Representatives of Services Firms (September 10, 2003; October 2, 2003).

Table 7.4c. Business Firms: Ranking of the Issue of Currency Convertibility (nine firms). Scale of 1-10; (1 being the least important, 10 being the most important)

Currency Convertibility	Number of Representatives	Responses in Addition to a Ranking
Ranked CC a 1 or 2	2	(2) Important that the firm is paid in dollars.
Ranked CC a 4	1	
Ranked CC a 5 or 6	4	(2) Not really the issue, concern is that the firm is paid in dollars.
Ranked CC a 6 or 7	1	
Ranked CC a 10	1	(1) Employees paid in local currency
Able to get paid in dollars	1 – Did not rank	

Note: CC stands for Currency Convertibility

This is logical because these types of firms would be the most affected by issues of currency convertibility since they are likely to be more involved in the local business.²⁴⁰ However, the median ranking of this issue of at the level of “5 or 6” was still rather low considering the emphasis placed on this issue by the IMF and other US institutions such as the Department of Commerce. One representative discussed the issue of currency convertibility and why it was not a very important issue for the firm (the representative assigned it a ranking of “4”). The representative stated that

(t)he issue of currency convertibility was mainly a concern of the US, which then made it a concern of the firm. The US Treasury was interested in currency convertibility, but that it was not an issue for the firm because as long as the EXIM Bank secured the financing, it was not an issue.²⁴¹

²⁴⁰ In an interview with a representative from the Department of Commerce, the person stated that the issue of whether the Uzbek government would agree to convertibility of the currency would have the greatest impact on the business already in the country. This was the day after the Uzbek government announced the convertibility of the *som* (October 16, 2003)

²⁴¹ Interview, Business representative, October 16, 2003.

This connection between currency convertibility and the financing of the EXIM Bank will be explored in the next section on the ranking of the economic reform indicators.

Ranking of Economic Reform Indicators

At the end of each interview each representative was given a final questionnaire and asked to rank four indicators comprising the dependent variable of economic reform (see Appendix A). The responses of the representatives from the services firms will not be analyzed because, as noted previously, they often stated that their focus on economic reforms was limited because they let the bigger firms deal with those issues. The indicator that representatives of firms with investment for natural resources ranked as the most important to the investment decision of the firm was that of foreign investment laws (see Table 7.5a).

Table 7.5a. Firms with Investment for Natural Resources: Ranking of Economic Reform Indicators (seven firms) (1 most important, 4 least important)

Indicator	1	2	3	4
Foreign Investment Laws	5	1	1	
Privatization Program/Legislation		3		4
Reform Measures Undertaken in Sector of Investment/Business	1	2	2	2
Trade Liberalization/Foreign Exchange System	1*	1	4	1

*Firm had investment as well as business in the countries.

Four out of the five representatives that ranked this indicator as the most important also stated that contract legislation should be included in this category.

The results of this questionnaire correlate with the responses of these representatives to the open-ended question that asked which specific areas of economic reform influenced the investment decision (see Table 7.2a). Those answers all corresponded with some type of legislation including contract laws, sanctity of the contract, foreign investment laws, and Production Sharing Agreements (PSA's).

The indicator for currency convertibility was ranked as unimportant, as expected, with only the representative of the firm with direct investment as well as business in the countries ranking this indicator as the most important. The low ranking of the indicator for reform measures undertaken in the sector of investment is surprising, because it would seem to be closely correlated with the indicator for foreign investment legislation. However, it is possible that the indicator was not presented clearly enough, and possibly representatives viewed this indicator as completely separate from investment legislation. The disparity in the ranking of the privatization program indicator (four representatives ranked it as a "4"; while three representatives ranked it a "2" can likely be explained by differences between the firms in working out the privatizing of state assets.

The indicator that representatives of firms having business involvement with the countries ranked as the most important to the business decision of the firm was that of the trade liberalization/foreign exchange system (see Table 7.5b).

Table 7.5b. Firms with Business Involvement: Ranking of Economic Reform Indicators (eight firms*) (1 most important, 4 least important)

Indicator	1	2	3	4
Foreign Investment Laws	1	3	1	3
Privatization Program/Legislation	1		4	3
Reform Measures Undertaken in Sector of Investment/Business	2	2	3	1
Trade Liberalization/Foreign Exchange System	4	3		1

*Two representatives stated that all of the variables were important and that each country would have criteria that were too detailed.

This finding at first seems contradictory to the results from Table 7.4c, in which the majority of representatives ranked the issue of currency convertibility as a “5 or 6”; and only one representative ranked it a “10.” In fact, their responses are consistent when they are compared with the importance of the financing by the EXIM Bank. These representatives had stated that financing by the EXIM Bank, or a foreign financing bank was a crucial aspect of the firms’ decision to conduct business in the countries (see Table 7.3). Three of the four representatives of firms that ranked the trade liberalization/foreign exchange system indicator as a “1” also used the EXIM Bank, or a foreign financing bank for financing for projects or business in Uzbekistan. The issue of access to foreign exchange was so important that they required the EXIM Bank financing to mitigate the risk.

Therefore, the specific issue of currency convertibility was not important because the firm would not be concerned about it. These representatives stated previously that it was important that the firm be paid in dollars (see Table 7.4c;

the “responses column”). If a country could not pay the firm in dollars, or get private financing for the loan, then the EXIM Bank was used. Issues of currency convertibility would arise in cases where local employees were paid in domestic currency, and when firms would need to buy supplies for the local manufacturing. However, representatives consistently stated that problems of currency convertibility for these issues would not override a decision by the firm not to conduct business in the country.

Areas of Reform and Investment/Business levels

The differences in the progress of economic reforms are hypothesized to explain differences in the foreign investment levels and business climate. Kazakhstan’s progress on economic reform has resulted in higher levels of foreign investment. Kazakhstan’s progress on economic reform has also resulted in a less difficult climate for business, and a higher level of business. Conversely, Uzbekistan’s delay on economic reform has resulted in smaller levels of foreign investment. Uzbekistan’s delay on economic reform has also resulted in a more difficult climate for business, and a smaller level of business. The differences between the two countries in the specific areas of economic reform deemed important to investor representatives and business representatives will be examined in the following section. Specific areas deemed important by investor representatives to be examined include progress in foreign investment legislation and contract issues. Specific areas deemed important by

business representatives to be examined include banking sector reform and issues involving the use of the EXIM Bank or another foreign financing bank.

*Foreign Investment Legislation
Kazakhstan*

Kazakhstan enacted its Law on Foreign Investment in December 1994 (EBRD, 2001, p. 158). The law defines both legal and economic principles for foreign investment, including the protection of the investment and for procedures for settling disputes through arbitration authorities (OECD, 1998, pp. 40-43). An important component in this investment legislation was that foreign investors would be protected from changes in legislation for at least ten years from the time of their investment if the changes in the legislation would cause the foreign investor to be in less advantageous position (OECD, 1998, p. 76). The law additionally provides a framework for settling disputes between the investor and a state body. If a settlement is not reached by negotiation, then the investment dispute can be heard by international arbitration authorities; including The International Centre for the Settlement of Investment Disputes (ICSID), and arbitration authorities established through the United Nations Organisation for International Trade Law (OECD, 1998, pp. 42-43). This inclusion of an arbitration clause is an important component of a Production Sharing Agreement (PSA) because it outlines the rules and procedures whereby disputes will be settled, if a conflict develops (Johnston, 1994, pp. 168-169).

The new Tax Code legislation passed in July 1995 was also deemed important for investors because it modernized the tax system, improved incentives for investors by reducing tax rates, and legalized the rates of tax.²⁴² A Corporate Income Tax was set at a standard rate of 30 percent, and the Value-added Tax (VAT) was set at a uniform rate of 20 percent.²⁴³

This tax code was in effect until 2002, and "...was considered to be among the most comprehensive pieces of tax legislation in the former Soviet Union" (Suhir and Kovach, 2003, p. 4). This tax system does provide for a section on the Natural Resource Tax; but there is no set tax rate. Instead, the legislation stated that the tax "Varies depending on the contract."²⁴⁴ This is likely why investors for natural resources also stated that contracts and contract legislation were important components of economic reform that influenced the investment decision.

Kazakhstan has also passed petroleum legislation and was the first of the fSU countries to formalize a package of oil legislation (OECD, 1998, p. 115). An important component of this legislation was the decree "On Oil" passed by presidential decree on June 28, 1995.²⁴⁵ This decree is comprehensive, including articles for defining terms used such as "extraction" "contract" and "oil" and "oil operations" (Russia and Eurasia Documents Annual, 1995, p. 286-287).

²⁴² EBRD, 1996, p. 157; also see Table 6.7 in the previous chapter.

²⁴³ IMF 1996, Appendix II Summary of the Tax System, sections 1.2 and 3.1, pp. 55-57.

²⁴⁴ Ibid., Section 5, p. 39.

²⁴⁵ It is important to point out that this legislation was passed by decree under the law issued in December 1993, when the first Kazakh parliament was "voluntarily" disbanded, and powers were temporarily given to the President. This was necessary because the decree was passed when the parliament was disbanded in March (see the previous chapter for further explanation. Forsythe (1996) also pointed out that the final legislation was not passed until parliament was disbanded (p. 35) (Legislation located in Russia and Eurasia Documents Annual 1995, pp. 286-299).

This legislation also provides additional benefits for investors through a section stating that (Chapter 4, Article 15, Section 3)

If commercial amounts are discovered, a prospecting-license holder has the exclusive right to obtain an extraction license on condition that the requirements set down in the prospecting-license have been met.²⁴⁶

This section of the legislation was noted as being important in the analysis done by the OECD, in that it was different from the Russian oil legislation that only granted a priority right, not an exclusive right (OECD, 1998, p. 117). The Subsoil Code passed in January 1996, also provides for fees for the uses of natural resources and states that investors will be protected from future legislation that would damage the investors position (OECD, 1998, p. 116).

Production Sharing Agreement's, or contracts provide a framework for specific parts of a contract such as production areas, the value of petroleum, payments, employment and training of local personnel, and arbitration (Johnston, 1994, p. 156-170). Johnston's (1994) chapter on the production sharing contract outline organizes the importance of the legal/regulatory/contractual framework in the following order of importance

The Nation's Constitution
Tax Law
Petroleum Legislation
Production Sharing Contract
Joint Operating Agreement (p. 152)

²⁴⁶ Russia and Eurasia Documents Annual, 1995, p. 290.

This outline also illustrates the importance of tax legislation for investors.²⁴⁷ A Production Sharing Agreement (PSA) is then often viewed as more representative of the overall commitment to the legal and investment climate in a country. One representative from a natural resources firm stated that the area of economic reform the firm examined was the “host government’s willingness to honor the contract”; as an example he cited Russia’s reversal on a PSA as an example of a government not honoring the law (Interview, September 23, 2003). An additional representative stated that PSA’s were seen as “reputational agreements”; and that even procedural issues include an analysis of the host country’s commitment to “contract sanctity and rule of law.”²⁴⁸ Finally, one representative stated that in the areas of tax laws and bringing in advisors for technical assistance that Kazakhstan was “one of the first, and way ahead of the other (fSU) countries” to make these changes.²⁴⁹ Kazakhstan’s progress on investment related legislation has impacted its higher levels of foreign direct investment.

However, Kazakhstan also seemed to be attempting to alter some investment related legislation in the latter part of 2001. This legislation was described by government officials as “measures needed to increase exports and (were) not aimed at creating a monopoly to raise tariffs”; as some western investors had feared.²⁵⁰ Later, Nazarbayev stated officially that all contracts would be honored as previously agreed, and emphasized that the government

²⁴⁷ Weinthal and Jones-Luong (2001) found that Kazakhstan’s tax regime was important to foreign investors.

²⁴⁸ Interview, Representative of a Natural Resources Firm, October 14, 2003.

²⁴⁹ Interview, Representative of a Natural Resources Firm, October 2, 2003.

²⁵⁰ “Kazakhstan: Official Reassures Western Oil Companies” RFE/RL September 28, 2001.

“ha(d) no intention of revising the contracts signed” and that they would be “strictly” respected.²⁵¹ In an interview with a business associate, the associate hypothesized that Nazarbayev’s actions were the result of domestic pressures from the perception that the early deals negotiated with investors were too much in favor of the investors, and that his actions were taken to try and balance out the situation.²⁵² The associate also stated that it was likely that the Kazakh government realized that these actions would be harmful to future negotiations. The example the associate cited was a disagreement on a re-negotiation for a consortium deal, between a US oil firm and the Kazakh government, in which the Kazakh government eventually backed down, and the project proceeded.²⁵³

In the interviews with representatives of firms that had invested for natural resources, one representative stated that Kazakhstan was in some ways “still learning how to work with the oil companies”; in reference to the previous situation.²⁵⁴ An additional representative stated that changes in recent Kazakh legislation would affect some of their deals, but that “Kazakhstan had stood behind its agreement” with the firm.²⁵⁵ The recent agreement by a consortium of international as well as US oil firms to develop the Kashagan oil field seems to indicate that the oil firms are willing to continue to negotiate agreements with Kazakhstan.²⁵⁶

²⁵¹ “Nazarbayev Promises Investors No Revision of Contracts” RFE/RL Central Asia Report December 20, 2001; vol. 1, No. 22.

²⁵² Anonymous Interview, September 15, 2003.

²⁵³ Ibid.,

²⁵⁴ Interview, Representative of a Natural Resources Firm, September 23b, 2003.

²⁵⁵ Interview, Representative of a Natural Resources Firm, October 2, 2003.

²⁵⁶ “Oil Majors Agree to Develop a Big Kazakh Field.” *New York Times*, February 26, 2004, pp. W1, W7.

*Foreign Investment Legislation
Uzbekistan*

While representatives of the government of Uzbekistan have stated that they encourage and welcome foreign investment for its natural resources²⁵⁷ the country has not implemented the same framework for investment as Kazakhstan.²⁵⁸ The two main areas of difference between the countries are in the area of foreign investment legislation and tax legislation.²⁵⁹ Uzbekistan passed its first Law on Foreign Investment in May 1994, and was amended in May 1995, and in August 1997 (EBRD, 1999, p. 282). The fact that so many revisions have been made to the legislation would make it difficult for investors to keep track of the most recent changes.²⁶⁰ A new Law on Foreign Investment passed on April 30, 1998, had clarified some of the previous concerns of investors, but in many areas the legislation did not go far enough to protect investors.²⁶¹

Investors would also be concerned about the consequences of changes in legislation due to the repeated references in the recent Foreign Investment Law to guarantees and privileges granted by "current legislation." For example, in Article 5 "Forms of Foreign Investment" the second to last paragraph states that

²⁵⁷ Interview, Official from the Embassy of Uzbekistan, July 11, 2002; October 9, 2003.

²⁵⁸ Interview, Official from the Department of Commerce, October 16, 2003.

²⁵⁹ The OECD stated that "further improvements" for Uzbekistan's business development and foreign direct investment were needed in the areas of "foreign exchange convertibility, banking reform and taxation" (1996, p. 9).

²⁶⁰ The OECD listed 37 main laws and decrees issued by Uzbekistan that were related to foreign economic activity, and these were laws passed only from 1991-1994 (1996, p. 99-100).

²⁶¹ See the article "Two Views of the New Uzbek Laws on Investors' Rights"; reprinted with permission from Russian and Commonwealth Business Law Report, on BISNIS On-Line (<http://www.bisnis.doc.gov/bisnis/country/9807uzin.htm>).

Foreign investors may make investments within the territory of the Republic of Uzbekistan in other forms which do not contradict current legislation.

Article 6 “Enterprises with Foreign Investment” also states that foreign investors

...may found enterprises with foreign investment on the territory of the republic of Uzbekistan and enjoy all the rights, guarantees, and privileges granted by the current legislation of the Republic of Uzbekistan.

This would be a problem for investors because it provides no clause such that if future legislation is unfavorable to the investor, then the previous legislation will be applied. Geller (1998) also pointed out this contradiction regarding investor’s rights legislation and the legislative acts of international treaties in Article 22.²⁶²

Article 22 “Conflicting Provisions” states that

In the event of any inconsistency between the provisions of this Law and other acts of legislation or international agreements of the Republic of Uzbekistan, the provisions most favorable to foreign investors shall prevail.

Geller stated that this was not clear because

In a dispute between two foreign investors, one law may favor one investor, and another law may favor the other investor. The article should have said that the most recent legislation prevails.²⁶³

Additionally, this Foreign Investment Law has had at least two amendments and supplements since its passage; on June 14, 1999 and on May

²⁶² See her responses to the Uzbek legislation in the article under the section “Attorney Says Uzbek Investor Protection Laws Do Not Go Far Enough” (<http://www.bisnis.doc.gov/bisnis/country/9807uzin.htm>)

²⁶³ Ibid.,

26, 2000.²⁶⁴ One business associate explained that a problem for the Uzbek leadership is they are trying to attract investment but not necessarily investors.

The associate stated that

The leadership wants investors just to be able to send their money, that the idea of “investment” and others making decisions was not a desirable one.²⁶⁵

A representative of a natural resources firm that had invested in Uzbekistan stated that the firm was hopeful that Uzbekistan would pursue economic reforms, and that the “situation currently in Uzbekistan (was) impacting the decision to continue to do business in the country.”²⁶⁶ Specifically, the representative stated that the firm was having “problems negotiating transactions.”²⁶⁷

Uzbekistan has not passed any petroleum or oil legislation. Uzbekistan’s reserves of oil are likely not as large as Kazakhstan’s, but one investor did state that they had looked into investing in the sector, but that they likely “walked or ran away.”²⁶⁸ Uzbekistan has passed Tax Code legislation, albeit much later than Kazakhstan, in January 1998 (EBRD, 1999, p. 282). It seems that this was part of a broader aim to attract foreign direct investment, which included the establishment of an “ambitious privatization program” in 1998/99, which still did

²⁶⁴ See Law Republic of Uzbekistan May 26, 2000 No. 77-11, On the introduction of amendments and supplements to Law of the Republic of Uzbekistan “On Foreign economic Activity of the Republic of Uzbekistan.”

²⁶⁵ Anonymous interview, July 11, 2002.

²⁶⁶ Interview, Representative of a Natural Resources Firm, September 30, 2003.

²⁶⁷ Ibid.,

²⁶⁸ Interview, Representative of a Natural Resources Firm, September 23b, 2003; an IMF economist stated that Uzbekistan may have more oil than is currently realized, but that it was difficult to ascertain because it had not been explored (Interview, July 9(a), 2002).

not allay the concerns of investors about the business environment in Uzbekistan (IMF, 2000, p. 31).²⁶⁹

The Tax system does provide for an income (profit) tax for most enterprises, but it excludes important enterprises, and does not have a standard rate similar to Kazakhstan's Corporate Income Tax. The excluded enterprises include the "trade and food services enterprises, and payers of the unified tax and unified land tax." The rates of the tax vary, with a maximum rate set at 35 percent, and the rate for 1999 was set at 33 percent. Additionally, there is a separate rate for "Production enterprises with foreign investments" in which the rate depends on the percentage of foreign capital; and there is a separate rate for exporter-enterprises depending on the percentage of the firms' exported goods as a result of their own production.²⁷⁰

This tax system also provides a "Tax on the Use of Mineral Resources"; whereby the Cabinet of Ministers of the Republic of Uzbekistan determines the tax rate. This is different than Kazakhstan's Tax Code whereby the tax rate would vary depending on the contract. It is also likely that investors would be concerned about legislation passed by the Cabinet of Ministers that could arbitrarily change an established rate, since it would not be established in a contract. Therefore, Uzbekistan's lack of progress on investment and contract legislation has impacted its lower levels of foreign direct investment.

²⁶⁹ Uzbekistan's progress on tax policy from 1992-mid 1998 was ranked as a "4" with the scale from 1 (high degree of appropriate market-oriented reform) to 5 (very little, if any, reform); Kazakhstan's progress was ranked as a "2" (Ebrill and Havrylyshyn, 1999, p. 10).

²⁷⁰ IMF, 2000, Appendix III Overview of the Tax System of Uzbekistan, section 1 pp. 95-98). There is also a Value-added Tax set at 20 percent, with a lower rate of 15 percent for certain goods (see section 6, p. 101).

Banking Sector Reform and the Use of a Financing Bank

The previous areas of economic reform differences between the two countries have likely influenced the decisions of firms to conduct business in both countries as well. Additionally, all firms interviewed for this study had business or project involvement in both countries except for one firm that only had done business with Kazakhstan.²⁷¹ This is important because it allowed for a comprehensive analysis as to whether there were differences between representatives' views of conducting business in either country, and whether they were based on areas of economic reform. Representatives consistently stated that rule of law, finance reform, accounting standards, and banking sector development were important areas of economic reform that the firm considered when making business decisions. This section will compare each country's progress in banking reform, and will examine issues surrounding the use of a financing bank for business and projects.

The development of effective financial systems was stated as being a "central challenge" to the transition economies (EBRD, 1995, p. 19). Uzbekistan and Kazakhstan have had different levels of progress on the transition indicator category of "Banking Reform and Interest Rate Liberalization" from 1995-2002 (see Table 7.6).

²⁷¹ Uzbekistan is the most populous of the CAS (25 million in 2002, with a growth rate at 2.1 percent). The country's large population has likely influenced business decisions into the country, especially for consumer goods. Kazakhstan has a much smaller population (14.9 million in 2002) but is the largest geographically of the CAS; see Map 1 in Appendix B (<http://www.worldbank.org/data/databytopic/population.html>). World Development Indicators (WDI 2004, table 2.1.pdf).

Table 7.6 Comparison of Rating of Banking Reform and Interest Rate Liberalization for Kazakhstan and Uzbekistan: 1995-2002.

Country	1995	1996	1997	1998	1999	2000	2001	2002
Kazakh.	2	2	2+	2+	2+	2+	3-	3-
Uzbek.	2	2	2-	2-	2-	2-	2-	2-

Data from EBRD Transition Reports, Transition Indicator Tables, various years. The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little progress beyond establishment of a two-tier system and 4+ represents the standards and performance norms of advanced industrial economies (EBRD, 1999, p. 25).

The largest rating difference between the countries first occurs in 1997 (see Table 7.6).²⁷² In August 1995, Kazakhstan adopted new banking legislation, which among other things confirmed the independence of the Central Bank, and the adoption of some Bank for International Settlement (BIS) guidelines (EBRD, 1996, p. 157; see also Table 6.7). In the beginning of 1997, Uzbekistan formally implemented the Multiple Exchange Rate Regime (MER). While a modern law on the Central Bank had been passed in December 1995, foreign exchange transactions continued to be done through the National Bank for Foreign Activity (EBRD, 1996, p. 184). There was no other significant banking reform undertaken, especially considering Uzbekistan's ranking stays the same (at 2-) through 2002 (see Table 7.6).

Reform of the banking system, including issues of currency convertibility would all be considerations for firms considering conducting business in both

²⁷² In an interview with an IMF economist, the economist stated that in fact, there was a big difference between a category 2+ and a category 2- (Interview IMF economist, July 8, 2002).

countries. Representatives consistently stated that EXIM Bank or another foreign financing bank was crucial to projects going forward in Uzbekistan. Firms did not need to use these types of banks for projects in Kazakhstan because Kazakhstan would have been able to receive commercial financing. One representative of a firm that stated that the firm used the EXIM Bank for a project in Kazakhstan stated that it was due to the higher level of business in Kazakhstan.²⁷³

Therefore, while the difference in the number of firms conducting business in Uzbekistan compared to Kazakhstan was not substantial; this business would have been reduced dramatically if the firms could not secure financing for their projects or business. Some representatives did state that more business was done in Kazakhstan due to more business opportunities²⁷⁴; therefore Kazakhstan had a somewhat higher level of business. However, no representatives stated that the lack of reform in Uzbekistan was severe enough for the firm to conduct business elsewhere, as long as the financing could be arranged.

Conclusion

The chapter has shown that the economic reform differences between Kazakhstan and Uzbekistan have influenced the investment and business levels in each country. The most interesting finding from the results of interviews with investor and business representatives was how each firm dealt with issues of

²⁷³ Interview, Business representative, September 30, 2003.

²⁷⁴ Ibid., ;September 16, 2003; December 1, 2003; October 30, 2003.

economic reform based on their perceived risk of involvement with the countries. This finding also indicates that there is still a level of concern for firms to conduct business in these countries.

Therefore, while Kazakhstan has progressed further than Uzbekistan in areas of economic reform, there is still a level of concern about the business environment in Kazakhstan. This is also evident by the fact that only representatives from very large firms were interviewed for this chapter; the business environment is not likely secure enough for smaller firms to assume this risk. This was also a point made by one representative of a natural resources firm; that "smaller companies (often) look at what happens to the bigger firms because the bigger firms can afford more risk."²⁷⁵ The natural resources firms due to their direct investment in the oil and gas sectors encountered the biggest potential risks, and therefore representatives of those firms looked closely at areas of economic reform including foreign investment laws and contract issues. The services firms minimized their risk by virtue of being contracted by the natural resources firms (that assumed the risk) for engineering and construction services, and stated that the risk to the firm, and therefore a focus on economic reforms was minimal.

The business firms were the most affected by currency convertibility issues of all the categories of firms, due to their involvement with local business including equipment, manufacturing and projects. However, these firms were also able to mitigate their risk of currency convertibility problems with Uzbekistan by using the Export Import Bank, or another foreign financing bank. Therefore,

²⁷⁵ Interview, Representative of a Natural Resources Firm, October 14, 2003.

while this often resulted in a smaller level of business in Uzbekistan, it did not result in a substantial number of firms deciding not to do business with the country. The issue of currency convertibility has been stated as the one of the most important differences between Kazakhstan and Uzbekistan. However, the results from this chapter have shown that firms have managed to get around this issue. Natural resource firms are less concerned about this issue because they can sell these commodities on the world market for dollars. Business firms are not concerned about this issue as long as bank financing can be arranged. Even paying local employees in domestic currency was not a problem that was serious enough to dissuade natural resource or business firms.

This is an important finding because it has implications for Uzbekistan's recent decision to agree to complete convertibility of the currency (October 15, 2003). Specifically, the results from these interviews indicate that this decision by Uzbekistan may be less likely to bring in additional foreign investment and business unless other areas of economic reform are implemented. In an interview with IMF economists about this issue, the economists stated that currency convertibility was a necessary but not a sufficient condition to improve the overall economy.²⁷⁶ This issue as well as the summary of the results of the previous chapters will be presented in more detail in the concluding chapter.

²⁷⁶ Interview, IMF economists, October 22, 2003.

Chapter 8: Conclusion

Summary of the study

The purpose of this study was to determine reasons for the differences in the economic reform processes of Kazakhstan and Uzbekistan, as well as to determine the relationship of reform to investment and business decisions. To investigate this problem a systematic analysis of variables hypothesized to better understand the differences in the economic reform strategies of each state was employed. The project additionally used interviews conducted with economists from the financial institutions as well as interviews with other representatives from the business community to complement the data analysis. Interviews conducted with representatives of firms who had invested or conducted business in the case study countries confirmed that there were specific areas of economic reform that were considered in the investment/business decisions.

The following section will summarize and discuss the findings from the research hypotheses. Then, the implications from the results of the research will be reviewed including the limitations for the results of this study. Finally, suggestions for further research and study will be presented.

Summary of the Results

The analysis of each republic's level of integration with Russia during the Soviet era was an important indicator of the future progress of each republics

economic reform in two ways. Specific indicators for the integration levels (geographic, political and economic) were used to allow for a systematic analysis of these indicators as they influenced each republic in different ways. First, while it is common knowledge that Kazakhstan borders Russia, and that Uzbekistan is geographically more distant, the geographic indicator explained other differences in integration. Kazakhstan's electrical power, coal systems, and oil and gas pipeline structures were all linked with Russia's. The government of Kazakhstan then had to decide whether to continue to operate with Russia's integrated system, or whether to engage the international community through decisions made about more international economic orientation. Uzbekistan was the third largest producer of natural gas in the fSU, and more importantly the production of gas was primarily for domestic industry, very little was exported to Russia (World Bank, 1993b, pp. 4-5). Uzbekistan was additionally endowed with large gold deposits, as well as raw cotton that the government was able to export. These resources provided important sources of revenue for the state. The government of Uzbekistan then did not depend on an integrated system with Russia, in order to function at the same economic level at independence. Therefore, the government pursued less international economic orientation.

Second, the political and economic indicator focused on differences in demographics in each republic, and on the policies pursued by each former First Party Secretary during the Brezhnev period. Kazakhstan's level of political integration with Russia was stronger than that of the other republics due to the republic's minority of Kazakhs and the plurality of Russians throughout most of

the nations history. Uzbekistan had a plurality of Uzbeks, and therefore had a lower level of political integration with Russia. The relationship between Uzbekistan and Russia was further strained as a result of Rashidov's policies of falsifying increases in cotton production and the resulting "cotton affair." While the characterization of the cotton affair from Moscow was portrayed as an event of corruption and bribery; the Uzbeks in Uzbekistan viewed it as an unfair prosecution and portrayal of Uzbeks.

The data also showed that the importance of each of the former First Party Secretary's was dependent upon how each of the subsequent leaders dealt with their influence. In Uzbekistan, policies that focused on the importance of cotton production and growing would be continued under Karimov. In Kazakhstan, Nazarbayev would largely disassociate himself from Kunaev for political reasons; a policy he began while Kunaev was still First Party Secretary. These actions would also explain their divergence on economic policies when they became president. Karimov would largely embrace past policies, and make less progress on economic reforms. Nazarbayev would look to the future, and make more progress on the advancement of economic reforms.

The analysis of the strength of the pursuit of economic reforms by each leader was the strongest indicator as to whether reforms would be advanced or delayed. This is logical because strong leaders rule both countries, with any substantive opposition suppressed. More importantly, when there were instances of opposition (in Kazakhstan), Nazarbayev manipulated the political

system in order to bring in people that would support his policies and to oust his opponents.

The variable of the level of turnover of the former Soviet elite was an important indicator of the progress on reform, but only when this variable was considered in the broader framework of the leader's pursuit of reform. The low turnover of the former Soviet elite (representing the president and governmental officials) in Uzbekistan correctly predicted that economic reforms would be delayed. The high turnover of the former Soviet elite (representing governmental officials) was only partially correct in predicting that economic reforms would be advanced in Kazakhstan because Nazarbayev is a member of the former Soviet elite. In fact, Nazarbayev's background of being promoted up through the Communist party ranks would seem to make it more likely that he would be beholden to the interests of the former elite. Karimov was not promoted up through the Communist party ranks, yet he continued with many of the former Soviet elite as governmental officials. Therefore, the hypothesis about the level of turnover of the former Soviet elite does not independently explain why one president delayed reforms and why one president advanced reforms. The differences in integration levels during the Soviet regime, which largely explained the diverse policies implemented by each leader, are additionally necessary to understand the advancement or delay on economic reforms.

Finally, the results from the interviews with representatives of firms that had invested or conducted business in the case study countries were able to establish some degree of a relationship between progress on economic reforms

and foreign investment/business levels in Kazakhstan and Uzbekistan. The data lead to an important finding. Specifically, that each type of firm understood the variable of economic reform in different ways based on the type of risk that the firm perceived as important to their investment or business decision. The natural resources firms had the greatest risk (reversal of contracts, nationalization) and therefore the areas of economic reform that they focused on had to do with foreign investment legislation and issues of sanctity of the contract. This last indicator is difficult to quantify but investors seemed to equate contract issues with Production Sharing Agreements, including tax and petroleum legislation. The services firms were the least concerned about areas of economic reform because they were contracted and paid directly by the natural resources firms. Therefore, these firms understood that 1) the natural resources firms would assume most of the risk (they had the most to lose) and 2) they would be paid by the natural resources firms for their services when the contract was arranged. Therefore, this largely negated any issues of currency convertibility problems, and the only concern for the firm if the project did not work out would be the re-locating of personnel (Interview, Representative of a Services Firm, September 10, 2003).

The most unexpected finding was the large number of firms that conducted business in both case study countries. Due to Uzbekistan's slower progress on economic reforms, and most importantly on the issue of the non-convertibility of the currency (until October 15, 2003), the hypothesis was that this would explain the smaller level of investment/business into the country. This

hypothesis was true for the natural resources firms and resulted in lower levels of foreign direct investment. This also resulted in a smaller level of business in Uzbekistan, but not in a substantial number of firms deciding not to do business in the country. Nine out of ten firms that conducted business in the case study countries did business in both Kazakhstan and Uzbekistan; only one firm had only conducted business in Kazakhstan. While the business firms were the most concerned about currency convertibility issues (in Uzbekistan) they were able to mitigate their risk of currency convertibility problems by using the Export-Import Bank, or another foreign financing bank to secure the financing for the business. The issue of currency convertibility was important, but the firms would still do business with Uzbekistan if the financing could be secured.

However, the results from the data derived from interviews are limited in their scope in some areas. First, it was not anticipated at the onset of the project that representatives would agree to be interviewed only on the condition that the firms they represented would not be named in the study. It was anticipated that anonymity would be requested for the interviewees and this was explained in the disclosure form. Therefore, it was not possible to report some of the stronger results from the interviewees in the analysis if the identity of the firm could possibly be determined from the disclosure of the information. Second, while the total number of firms was representative of the number of firms that met the criteria for the study, it was a small sample (twenty total firms). Therefore, while it would not be possible to draw statistical inferences from the results of the interviews, the findings support the expectations of a relationship between

progress in areas of economic reform and increased levels of investment/business confirmed in other sources of data. This is evident in the comparison of differences between the progress of each country on the economic reform indicators deemed more important by investor and business representatives.

The Relevance of the Findings

The purpose of this study was to better understand the differences in the economic reform strategies of two post-Soviet republics. This study differed from previous studies in that it used a detailed analysis of historical and political influences on reform, combined with data about each country's progress on economic reform. Zettlemeier's (1998) study on "The Uzbek Growth Puzzle," for example, explained much about why Uzbekistan's output fell less than any other fSU republic even though the country had not proceeded with rapid economic reforms. Primarily the paper found that Uzbekistan's combination of low industrialization, its ability to export cotton, and energy self-sufficiency explained most of the "puzzle." However his study did not analyze how Uzbekistan was less integrated with Russia in these sectors during the Soviet Union, and that this lower level of integration might have explained the government's ability to have more control over the export of its resources than the other fSU.

The results of this study also have implications for understanding the reform efforts of the other former Soviet Union republics. The framework of this project could be extended to a study of Kyrgyzstan's early progress in the areas

of political and economic reform, and why the country has not continued to progress as rapidly in these areas. Early results about Kyrgyzstan's progress attributed much of the country's progress to the fact that the leader was not a former member of the Soviet elite. However, the variable of the level of turnover of the former Soviet elite did not predict progress on economic reform in both case studies. Therefore, an analysis of other types of variables such as the integration levels during the Soviet era and the strength of pursuit of reforms by the leader may explain more about Kyrgyzstan's economic and political situation. Admittedly, this variable is easier to analyze with a strong leader, but this study has shown that it is also important to look at the governmental officials, including the degree of the turnover of these officials from the Soviet era.

The findings of this study would be applicable to countries undergoing, or likely to undergo similar extensive economic reforms in the near future. This includes current communist countries such as North Korea and Cuba, which have similar economic and political circumstances and whose implementation and continuation of economic reform would be better understood using this project's broader focus on economic reform issues. A focus on the cultural and political histories of the newly transitioning countries of Afghanistan and Iraq would also be more likely to predict each country's progress on economic reform. The process in the development of Afghanistan's constitution has illustrated that tribal and historical circumstances will be important indicators to consider as this country progresses in the areas of political and economic reform. Due to the relatively uncertain business and investment climate in these new states it is also

likely that firms would consider the same types of economic reform areas, and would likely use non-private bank financing for facilitating business in this group of higher risk states.

Strengthening the Study

The study could be strengthened in a number of ways. First, while the use of the comparative method has allowed for more analysis than a single case study design, additional former Soviet republics could be added to the research design to test whether the hypotheses are correct in explaining the processes of economic reform for the other countries. Second, each of these countries has only been an independent state since 1991. Therefore, it is still early in the reform process of both of these countries to be able to predict whether they will continue on the trajectory of the reform process that this study has concluded. More time is needed to be able to state with certainty the progress that each country will have made on economic reform.

Finally, while the results of the interviews may be applicable for countries early in the economic reform process, they would not be applicable to more developed states. Related to this, the fact that only large well know firms fit the criteria for the study indicate that there is still a level of concern about business and investment in both of these countries. Therefore, the results concerning the influence of economic reform areas from the respondents of large firms could not be generalized to be representative of the responses of smaller firms.

Suggestions for Further Research

Further research about progress in economic reform and the relationship between reform and investment could proceed in a number of areas. First, there should be more analysis on the writings, and speeches given by presidents as indicators about how they view economic reform policies. This type of data analysis should also include previous positions a president held, as well as previous positions of the governmental officials that they appoint. Second, studies should focus on the economic policies that a government pursues after an economic downturn. This may be a stronger indicator as to whether a particular administration will continue to implement reforms, or will be more likely to reverse reforms based on other considerations. Third, serious attempts should be made to determine if governments realize the types of economic reforms that are desirable from the standpoint of investors or business representatives to invest or do business in their countries. The degree to which the stronger implementation of economic reforms can be shown to positively influence the greater economic picture may result in the quicker implementation of those policies.

Finally, future research should include an analysis of the role of financing banks to secure lending that is not available from private sector financing. This research would be an important contribution to understanding how these banks facilitate business in higher risk states that might not otherwise be able to attract that business.

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Appendix A: Types of Questionnaires

Questions for Investor Representatives in both Countries

1. What was the primary reason for the investment decision into Kazakhstan?
2. What was the primary reason for the investment decision into Uzbekistan?
3. Did Kazakhstan's implementation of economic reform influence the investment decision?
4. Did Uzbekistan's implementation of economic reform influence the investment decision?
5. Does the firm have investment in other Central Asian countries?
(b) Why?
6. In Kazakhstan, were there any individuals or Ministry heads that representatives were required to meet with, or that in meeting with them, any problems were more easily solved? (b) Do you feel comfortable stating which Ministry?
7. In Uzbekistan, were there any individuals or Ministry heads that representatives were required to meet with or that in meeting with them, any problems were more easily solved?
(b) Do you feel comfortable stating which Ministry?
8. Does the firm use country risk assessments such as those compiled by Euromoney magazine (rankings on variables such as economic performance, political risk, debt in default)?
(b) Are there other sources of assessments of political and economic risk used?

9. Since the firm has investment in both countries, did the economic reform differences between Kazakhstan and Uzbekistan matter in the investment decision?
10. What economic reform areas were examined due to their importance regarding the investment decision? Why?
11. In Kazakhstan, the predominant investment from the firm has been in _____. Has the firm considered investment in other sectors or areas? Why?
12. In Uzbekistan, the predominant investment from the firm has been in _____. Has the firm considered investment in other sectors or areas? Why?
13. Does the value of oil as a natural resource override an analysis of economic reform in either country?
14. Does the firm consider one of these countries to be a more stable environment for investment? Why?
15. How important (scale of 1-10) was the issue of currency convertibility for the business decision?
- (a) in Kazakhstan?
- (b) in Uzbekistan?

Questions for Business Representatives in both Countries

1. What was the primary reason for the business decision into Kazakhstan?
2. What was the primary reason for the business decision into Uzbekistan?
3. Did Kazakhstan's implementation of economic reform influence the business decision?
4. Did Uzbekistan's implementation of economic reform influence the business decision?
5. Does the firm have business in other Central Asian countries?
(b) Why?
6. In Kazakhstan, were there any individuals or Ministry heads that representatives were required to meet with, or that in meeting with them, any problems were more easily solved? (b) Do you feel comfortable stating which Ministry?
7. In Uzbekistan, were there any individuals or Ministry heads that representatives were required to meet with or that in meeting with them, any problems were more easily solved?
(b) Do you feel comfortable stating which Ministry?
8. Does the firm use country risk assessments such as those compiled by Euromoney magazine (rankings on variables such as economic performance, political risk, debt in default)?
(b) Are there other sources of assessments of political and economic risk used?

9. Since the firm has business in both countries, did the economic reform differences between Kazakhstan and Uzbekistan matter in the business decision?

10. What economic reform areas were examined due to their importance regarding the business decision? Why?

11. In Kazakhstan, the predominant business from the firm has been for _____.
(b) Has the firm considered business in other sectors or areas? Why?

12. In Uzbekistan, the predominant business from the firm has been for _____.
(b) Has the firm considered business in other sectors or areas? Why?

13. Does the firm consider one of these countries to be a more stable environment for business? Why?

14. How important (scale of 1-10) was the issue of currency convertibility for the business decision?

(a) in Kazakhstan?

(b) in Uzbekistan?

Final Questionnaire – Variable Ranking

Please rank the following variables as to their importance in the investment/business decision of the firm.

Each variable should be scored (1, 2, 3, 4) using each number only once, with a score of 1 indicating the most important variable.

____ Foreign Investment Laws

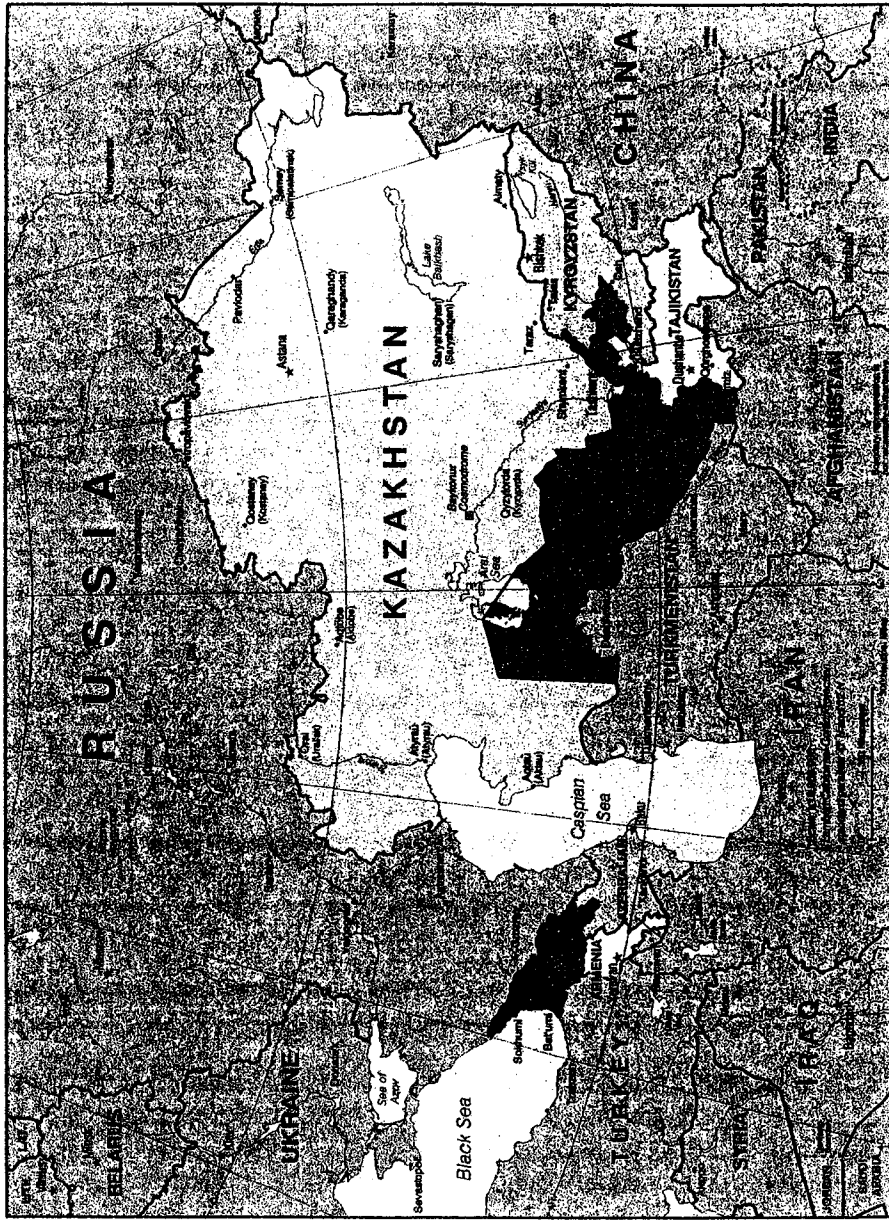
____ Privatization program/legislation

____ Reform measures undertaken in the sector of the investment
(agriculture, energy, or mining/metallurgy)

____ Trade liberalization and foreign exchange system

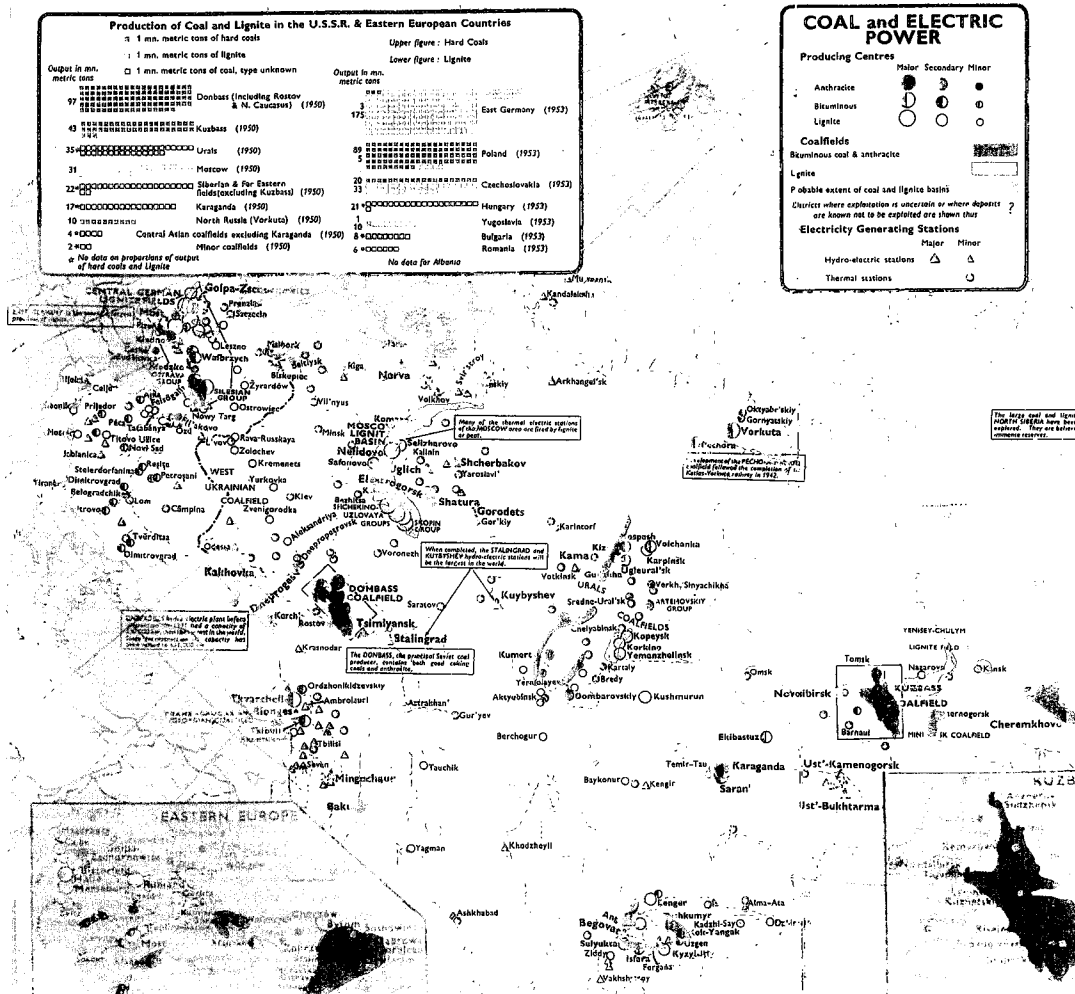
Appendix B: Maps

Map 1, The Caucasus and Central Asia
The Caucasus and Central Asia



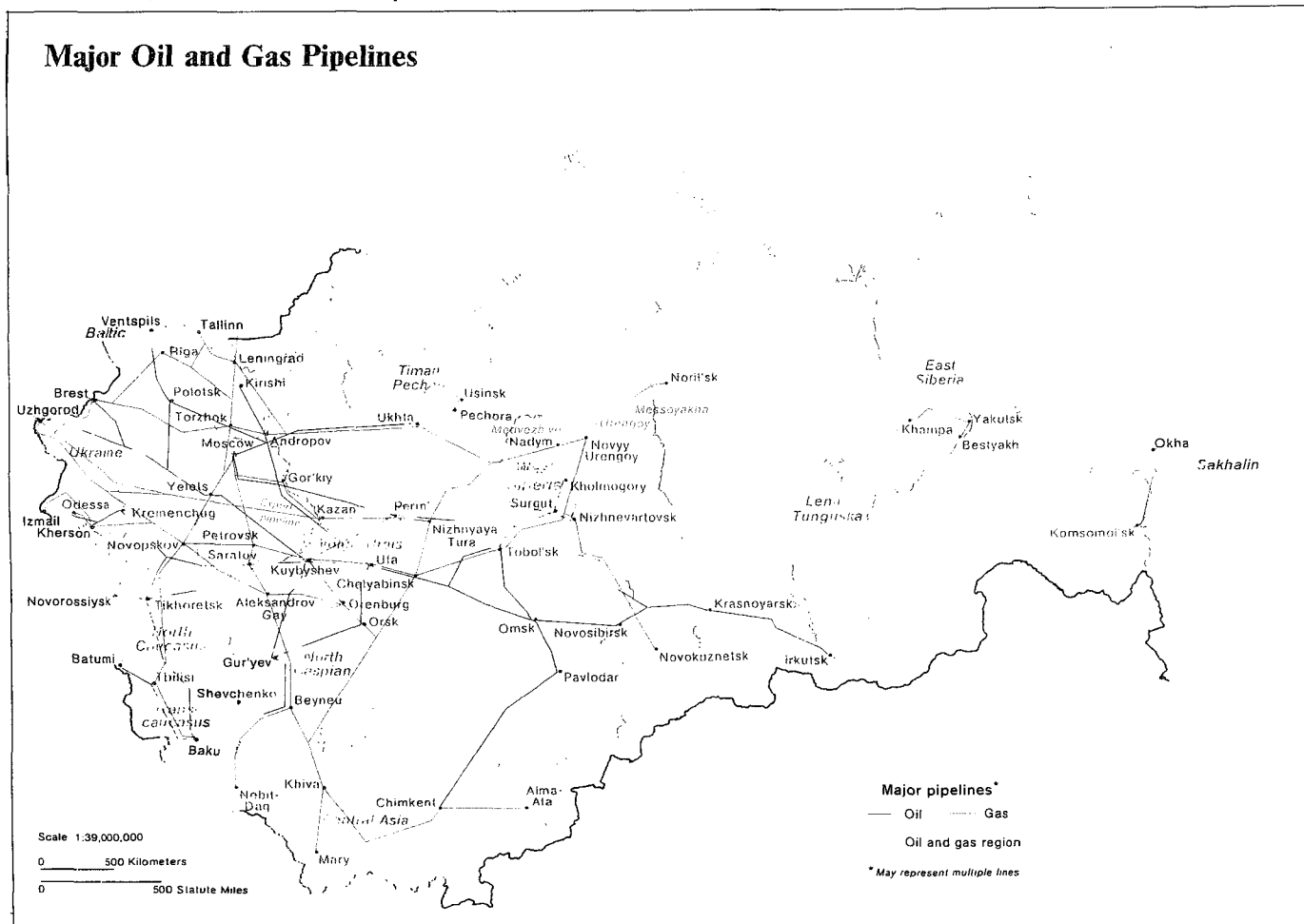
Source: CIA, January 2000.

Map 2, Coal and Electrical Power



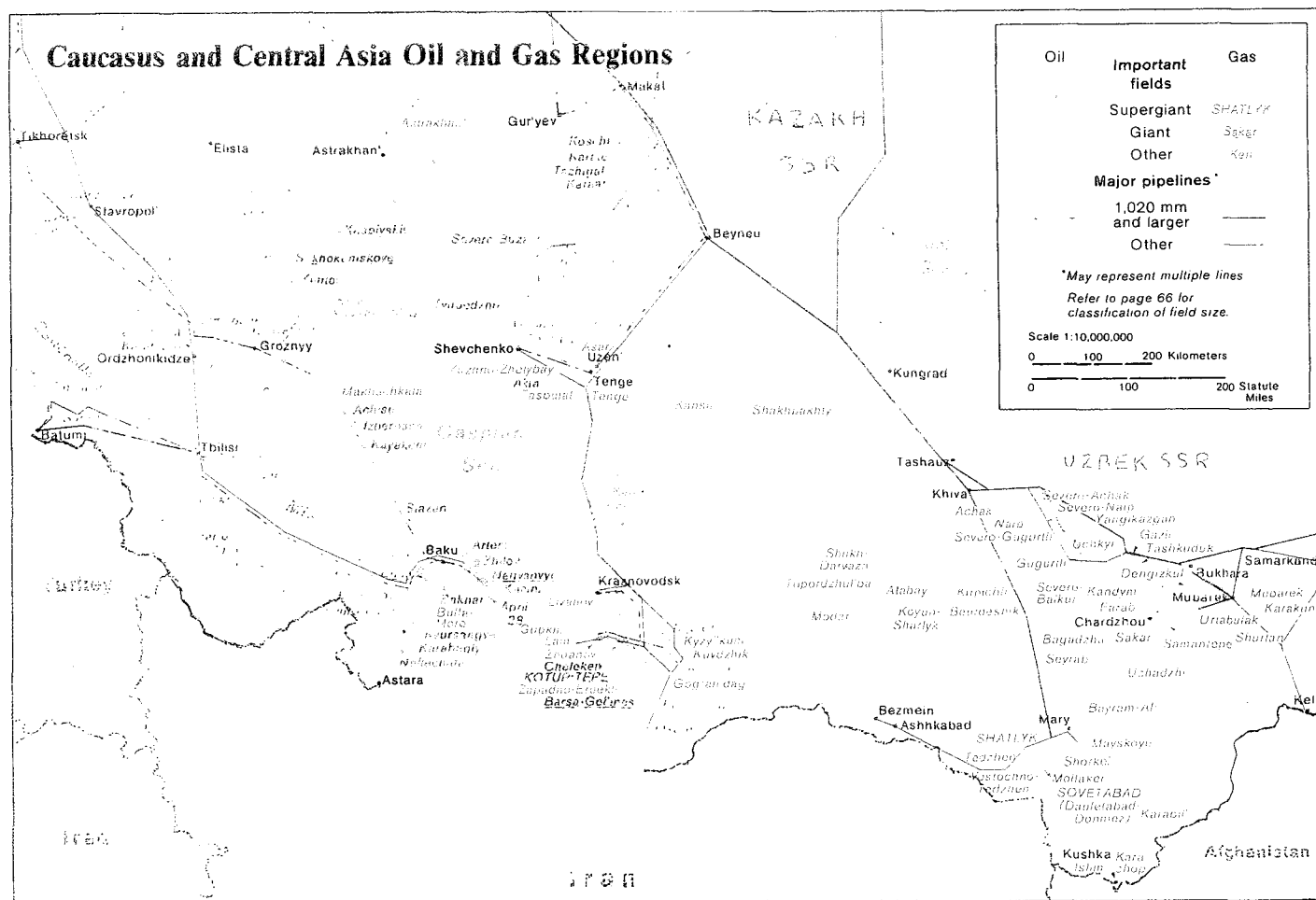
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 Source: Oxford Regional Economic Atlas, 1963,
 prepared by Economist Intelligence Unit and
 Cartographic Department of Clarendon Press.

Map 3, Major Oil and Gas Pipelines



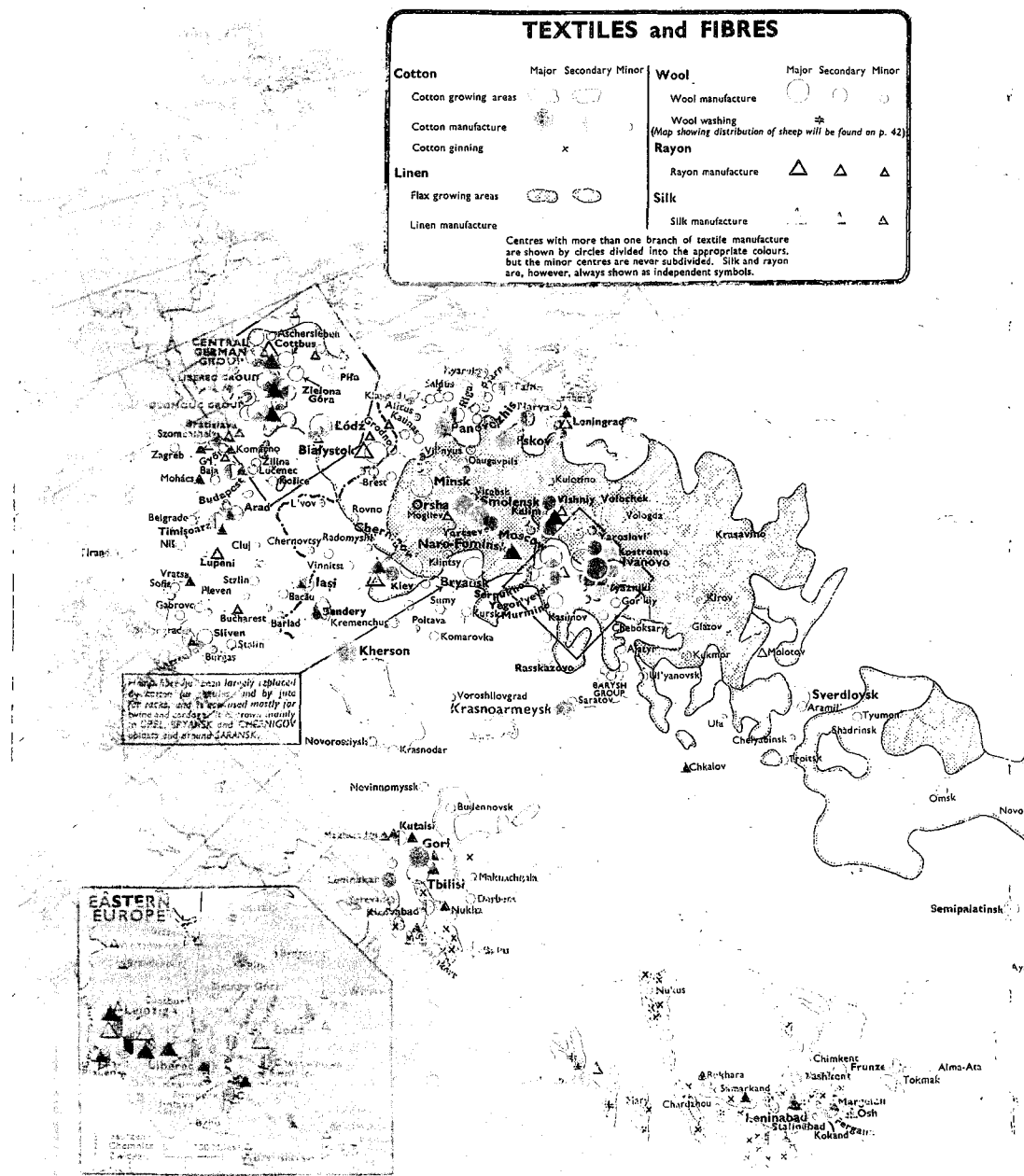
Source: CIA, 1985, USSR Energy Atlas.

Map 4, Caucasus and Central Asia Oil and Gas Regions



Source: CIA, 1985, USSR Energy Atlas.

Map 5, Textiles and Fibres



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