

Regionalisation in Central Asia

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1. Introduction

Regional cooperation and integration remains among the main topics of international discourse in Central Asia. In fact, though the issue of the regional integration is perceived differently for different regions of the former Soviet Union, the overall consensus is that increasing regional cooperation could be helpful for Central Asia or the Caspian Sea region from the point of view of economic development and overcoming common problems (Bartlett, 2001; Gleason, 2001). The literature, however, focuses on the top-down integration based on intergovernmental interaction. This form of integration seems to be extremely limited in the region. This paper, however, considers a different perspective on regional integration in Central Asia. It is generally accepted that the areas of relatively less effective regionalism could happen to be quite successful in terms of regionalisation (bottom-up integration), i.e. interaction of economic and political actors beyond the formal intergovernmental cooperation across national borders. The main elements of the regionalisation usually include stable trade networks and cross-border investments, linking the countries through international chains of production and migration.

It is possible to distinguish between two models of bottom-up integration. The first model ("investment integration") is based on FDI of large multinationals and implies relatively high levels of development of the leading countries of the region. The second model ("informal trade") is of a more archaic nature and is related to emergence of informal cross-border trade networks, mostly operating illegally. Some regions combine both models: for example, in East Asia the main drivers of integration are investments of Japanese multinationals and cross-border business networks of Chinese ethnic communities (Peng, 2000; Kawai, 2005); the relations between US and Mexico are similarly influenced by American multinationals (macuiladoras) and the informal network of Hispanic migrants. For example, the informal trade model is present in West Africa (Meager, 1997), and to a lower extent in South Asia (Taneja, 2001; Rafi Khan, 2007).

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This paper aims to analyse the role of regionalisation in Central Asia. Breslin (2000) presents two important caveats with respect to the comparative analysis of informal regionalisation. First, the borders of regions become fuzzy. If one defines a region as a cluster of economic and social ties, it obviously does not have any well-defined borders, unlike formal regionalism projects. Moreover, the choice of region of analysis may depend on mental maps, producing and reproducing “imagined” or even “invented” regions (Shenk, 2001; Miller, 2002). If the analysis of regionalisation is focused on qualitative data (e.g. because the quality of statistics is low, what is quite likely to be the case for the post-Soviet space – as well as in the developing and transitional world in general), the “mental maps” of *researchers* are likely to create biases for the research outcomes and especially for the claimed causal links. On the other hand, mental maps of actors (*indirectly influenced by academic discourse*) not only have an impact on the perception of regions, but also can indeed influence the processes of regionalisation and regionalism (through real or “invented” psychological distance, for example). Second, defining regions in terms of nation-states is not always productive for the analysis of informal integration – in particular, the so-called “microregionalism” and “microregionalisation”, based on the integration of subnational entities, can be very important.

In this paper, I define “Central Asia” as five former Soviet republics (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan). On the one hand, this approach is reasonable because countries of the region share a relatively long period of common economic and political history and closed interconnections, which in fact determined the process of nation- and border-building in Central Asia (see e.g. Hirsh, 2000; Abashin, 2007). However, on the other hand, Central Asia is still an “emerging region” (Kazantsev, 2005), i.e. its very concept, as well as structure of economic and political relations can be subject to re-definitions and turbulences. The second caveat is also ambiguous; all Central Asian countries are politically highly centralised (Ufer and Troschke, 2006; Leschenko and Troschke, 2006), while the Chinese experience (Breslin, 2000a) and the paradiplomacy of Russian regions (Magone, 2006) shows the need for decentralisation as a driving force of microregionalisation. But on the other hand, geographical dimensions (especially in Kazakhstan) and poor quality of transportation, as well as internal differences (like those between northern and southern Kyrgyzstan) could theoretically contribute to the clustering of economic activity on the subregional level.

2. Regionalisation in Central Asia

2.1. Post-Soviet regionalisation and Central Asia

In spite of extremely weak intergovernmental cooperation in the post-Soviet space, the region currently exhibits a substantial degree of the bottom-up integration. Basically, there are four factors contributing to this process.

First, since the early 2000s, Russian corporations have been increasingly present in the post-Soviet countries through takeovers, joint ventures, and – recently – greenfield investments (Heifetz and Libman, 2008; Deloitte, 2008). The investment expansion of Russian business is only partly registered by official statistics, since informal channels and offshore schemes are actively employed. Traditionally, three main sectors of expansion are oil and gas, metals and mining and telecoms, although currently a much larger diversification is observed. Second, post-Soviet countries are closely linked by migration flows (Ivakhnyuk, 2006; Ryazansev, 2008). Third, the post-Soviet space is still connected through a unity of infrastructure, e.g. in railroad and power utilities sectors, created in the Soviet times. Finally, there is still a significant (though permanently declining) degree of social integration in the post-Soviet world, manifesting itself in interpersonal networks and, above all, Russian as *lingua franca* for communication (Nasledie Evrazii, 2007). Hence, the regionalisation in the post-Soviet space seems to be driven partly by the Soviet heritage (which may happen to be a “disappearing reality”), and partly by the logic of regionalisation common for a typical geographical strategy of emerging multinationals (Davidson, 1980; Bell and Pennings, 1996; Kuznetsov, 2008). The post-Soviet regionalisation seems to be extremely asymmetric and clearly centred around Russia as the key market and key source of FDI in the region. Interestingly enough, there is no evidence of informal trade regionalisation in the CIS (unlike, e.g., Africa), what can be attributed to the specifics of industrial structure of post-Soviet economies, where (mostly global) trade in commodities dominates the trade structure, and to the overall level of economic development. The investment model seems to be much more important. Nevertheless, after significant decline of the 1990s the share of intraregional trade in the CIS reached a stable level; there is also evidence that the intraregional trade is still “too high” as opposed to gravity models predictions – a kind of inverted border effect (Fidrmuc, Fidrmuc, 2001; Djankov, Freud, 2002; Elborg-Voytek, 2003, de Sousa and Lamotte, 2007).

What does this highly asymmetric regionalisation imply for Central Asia? Theoretically, extraregional actors (like Russian corporations) could act as a driving force in the regionalisation process. For example, in East Asia Japanese and (partly) U.S. multinationals seem to contribute to the development of informal regional structures (Dobson and Yue, 1997). However, it requires two additional conditions: first, companies are present in several countries of the region, and second, their businesses are linked to each other. To our knowledge, there are extremely few areas where both conditions are satisfied. Two fields where Russian FDI could potentially increase the degree of regional interdependence in the Central Asia are telecommunications, where the “Big Three” Russian mobile service providers actively explore the regional markets, and power utilities, where the key player is INTER RAO UES. Given the fact that the energy systems of the post-Soviet countries are still

intervened, common actors in energy sectors can significantly contribute to regionalisation. However, one should be aware of the fact that the energy trade in the post-Soviet space decreased in the last few years, and that the modes of organisation of power utilities in individual Central Asian countries differ substantially. A third field where Russian extraregional actors could potentially become agents of regionalisation is oil and gas; however, currently the presence of Russian corporations in this sector is quite limited.

Finally, regionalisation through external actors – like in the “Greater China” area – is sometimes explained by the “intermediary function” accepted by certain regions and countries “canalising” foreign investments and trade in the region (Breslin, 2004). However, developed bilateral ties between Russia and post-Soviet countries make the use of these “intermediaries” less important. The situation is not unambiguously clear; for example, in October 2006, the president of the Association of Kazakh investors in Kyrgyzstan Bakhtybek Zheldibaev claimed that, as opposed to foreign investors from other countries, companies from Kazakhstan “... are in a more attractive position. First of all, Kyrgyz and Kazakhs have similar language, traditions, beliefs, psychology, reason and think in a similar way. Second, we do not need intermediaries. This is our advantage as opposed to European, Chinese and Russian investors. Actually, the latter also feel quite good [in the Kyrgyzstan], but we do not feel their pressure now” (Kuz'min, 2007).

Hence, Russian investors are probably not as close to Kyrgyzstan, as those from Kazakhstan, but the “distance” is still relatively small. However, as I will show below, Kyrgyzstan and Kazakhstan seem to develop deep economic relations, which are not present elsewhere. In Tajikistan, Russian investors are more important than those from Kazakhstan. One could of course speculate as whether increasing presence of Chinese investors will contribute to establishment of the “gate regions” to support regionalisation through external forces, but the outcome is yet to be seen.

2.2. Foreign Direct Investment

Let me now consider the actual intraregional factors of regionalisation. Unlike other subregions of the CIS, where the role of mutual investments is limited (for example, there is only vague evidence of some Ukrainian investment activity in Moldova – in particular, in Transdnistria and of Azerbaijan – in Georgia), Central Asia is quite different, mostly because of the activity of private and semi-private businesses from *Kazakhstan*, which actively explore the Central Asian countries. Though the main direction of investments for Kazakhstan is still Russia, it is increasingly present in the Central Asian region. As of September 30, 2007, Kyrgyzstan ranks 13th in the overall outward investments of Kazakhstan with about 1.3% of total foreign investments of the country (\$481 million, including \$240 million FDI). Uzbekistan ranks 20 with \$199 million (FDI: \$109 million), and Tajikistan ranks 21 with \$188

million (FDI: \$ 24 million). Hence, the countries seem to be of minor importance for the outward investment activity of Kazakhstan, with Russia, US, UK and British Virgin Islands (BVI) being the main targets for outward investments. However, one should take into account, that the Central Asian economies are relatively small, and hence even limited investment activity of Kazakhstan can become crucially important. Indeed, according to the investment statistics of the Kyrgyzstan, Kazakhstan is currently the dominant source of FDI for Kyrgyzstan, accounting for about 50% of the total investment inflow (see Figure 5.1). Unfortunately, there is no data on the FDI structure for Tajikistan and Uzbekistan available. However, applying the Kazakhstan data on FDI and total investments and national data from the balance of payment, one could establish, that for Q1-Q3 2007 Kazakhstan accounted for about 21% of total investments and about 4% of FDI inflow in the economy of Tajikistan (with Russia being the main investor accounting for about 40% of capital inflow).² One should, however, be aware of the presence of indirect investment channels (e.g. via the BVI investments), which have not been captured by the statistics above.

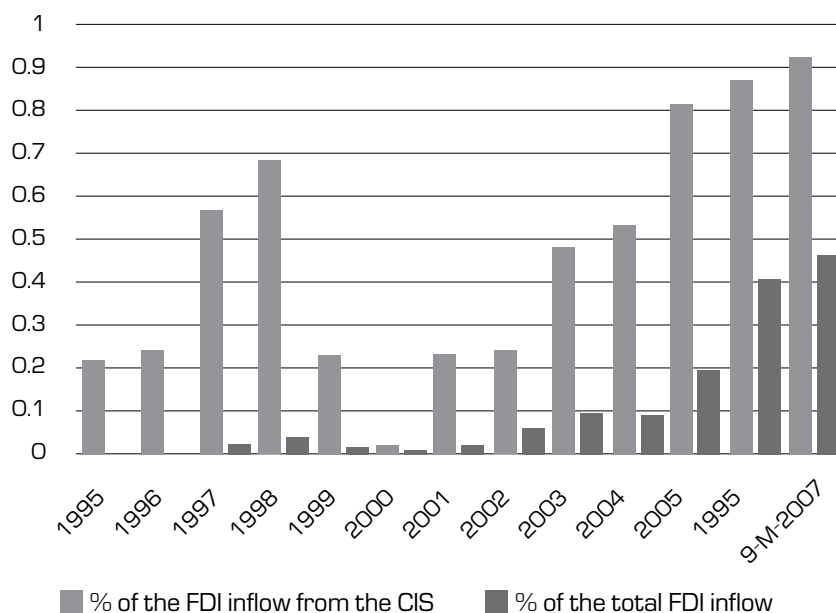


Figure 5.1.
Share of Kazakhstan
in the FDI inflow to
Kyrgyzstan

Source:
governmental
statistics of the
Kyrgyzstan

The low quality of statistical data makes the discussion of case studies of investment activity in the region necessary. In what follows, I list the main investment projects of Kazakhstan in other countries of the region. Most

² This indicator is extremely questionable. Generally direct comparison of outward and inward investment flows data from different statistical authorities of the CIS yields substantially different results (Vahtra, 2005); moreover, one faces the challenge of separating balance of payment statistics and methodology of statistical authorities, which also happen to be different.

projects I am aware of are implemented in Kyrgyzstan; it could represent the quality of data bias, however, from our point of view, reflects the true predominance of Kyrgyzstan-Kazakhstan connection in the regionalisation processes in Central Asia.

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

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

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

Adrasman mining complex in 2006 for \$3.2 million. In the field of gas supply, Kazakhstan's state owned *KazTransGaz* and Kyrgyz *Kyrgyzgaz* established a joint stock company, *KyrKazGaz*, in 2004 to operate the gas pipelines to the North of Kyrgyzstan and the South of Kazakhstan. As in the CIS in general, the dominant instrument is still the acquisition of existing assets, though there is an increasing presence of greenfield investments (like the recently initiated project of a ferrosilicoaluminium plant in Tash-Kumar [Kyrgyzstan] for \$100 million). BRK-Leasing, a subsidiary of the Development Bank of Kazakhstan, provided €7 million for financing the development of textile production in Bishkek. In December 2008, the ambassador of Kazakhstan in Uzbekistan Zautbek Turisbekov proposed to provide finance to farmers from the banks of Kazakhstan, as well as to establish joint food processing plants in the border zone. Finally, Kazakhstan seems to be extremely interested in power utilities in Kyrgyzstan and Tajikistan (in January 2008, Kazakhstan declared its plans to participate in the reconstruction of the Kambarada Power Plant in Kyrgyzstan, and in February – in the reconstruction of the Rogun Power Plant in Tajikistan); however, any perspectives in this field are still vague, especially given active position of Russian business in the area. The investment activity seems to be driven by both relatively cheap labour (compared to Kazakhstan) and access to natural resources. Access to markets seems to be less important in this sector (unlike banking services).

The opposite direction of investments from Uzbekistan, Tajikistan and Kyrgyzstan to Kazakhstan seems to be insignificant. In the first 9 months of 2007, Uzbekistan accounted for about 0.004% of total FDI inflow to Kazakhstan (or 11% from the CIS),³ and Kyrgyzstan for 0.008% (or about 22% from the CIS). There is no data on the investment activity of Tajikistan, as well as cross-border investments in Central Asia beyond Kazakhstan. To conclude, it looks like the Central Asian regionalisation is as asymmetric, as the regionalisation process in the CIS in general, with Kazakhstan as the main source of outward investments and Kyrgyzstan as the main recipient of FDI. In Tajikistan, investments from Kazakhstan are important, but less active, than those of Russia (in the Kyrgyzstan the situation is exactly the opposite). Uzbekistan and (especially) Turkmenistan are much less active in the development of intraregional investment ties.

2.3. Intraregional trade and migration

In case of the formal intraregional trade, the situation is similar to the CIS in general. Regional concentration of exports is characteristic to a certain extent

³ There are currently 96 enterprises with Kazakh investments functioning in Uzbekistan, including trade, construction, light industry, metals and food industry, and 715 small and medium enterprises with Uzbek investments in Kazakhstan, including trade, manufacturing, food industry, construction materials, glass, services and real estate operations (RIA Novosti, 2008, April 21). However, the quality of these data is very low and is hardly helpful for understanding the scope of international cooperation.

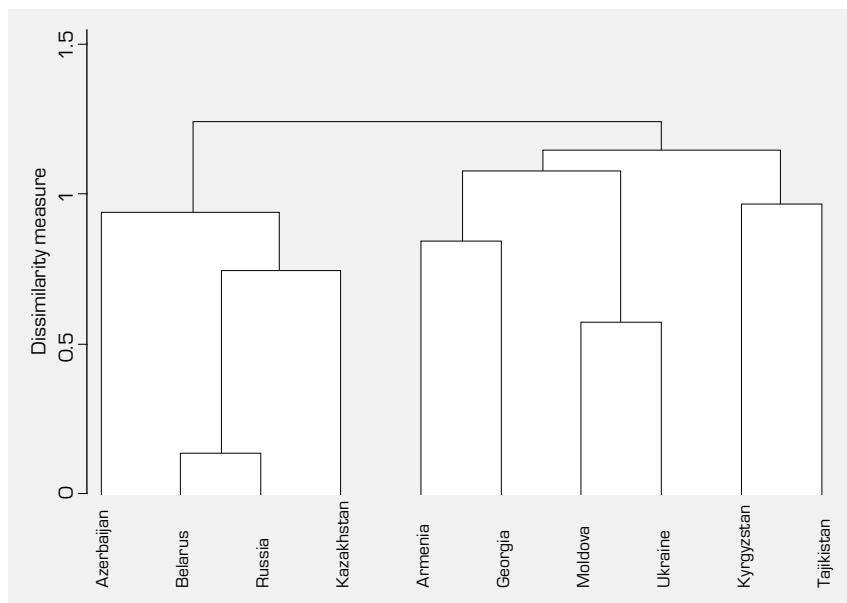
Table 5. 1.
Structure of
interregional and
intraregional trade in
Central Asia, 2006

Source:
CIS Statistical
Committee, 2007

for the Kyrgyzstan, mostly because of its closed economic ties to Kazakhstan. On the other hand, Tajikistan and Kyrgyzstan experience a certain degree of concentration of imports in the region (see Table 5.1). However, a slightly different result follows from the cluster analysis based on dissimilarity matrix (Figure 5.2). While Kazakhstan seems to have higher degree of market integration with Russia than with the rest of the CIS, Kyrgyzstan and Tajikistan indeed belong to one cluster. An additional factor potentially supporting the regionalisation is that Central Asian countries share a number of common problems of infrastructure, in particular for energy trade and water supply, where their economies are closely linked to each other (Vinokurov, 2007). Even if the value of trade is small, its importance for the development is crucial.

| From (exports), to (imports) | Indicator | Exports and imports | | | | | Total Central Asia |
|------------------------------------|------------------------|---------------------|------------|--------------|------------|------------|-----------------------|
| | | Kazakhstan | Kyrgyzstan | Turkmenistan | Tajikistan | Uzbekistan | |
| Kazakhstan | Share of total exports | | 0.700% | 0.054% | 0.412% | 1.006% | 2.171% |
| Kazakhstan | Share of CIS exports | | 4.804% | 0.371% | 2.824% | 6.902% | 14.901% |
| Kazakhstan | Share of total imports | | 0.587% | 0.560% | 0.117% | 1.348% | 2.611% |
| Kazakhstan | Share of CIS imports | | 1.255% | 1.199% | 0.250% | 2.884% | 5.589% |
| Kyrgyzstan | Share of total exports | 20.476% | | 0.264% | 3.010% | 3.513% | 27.264% |
| Kyrgyzstan | Share of CIS exports | 42.902% | | 0.554% | 6.306% | 7.361% | 57.124% |
| Kyrgyzstan | Share of total imports | 11.628% | | 0.105% | 0.163% | 3.783% | 15.679% |
| Kyrgyzstan | Share of CIS imports | 20.161% | | 0.182% | 0.283% | 6.559% | 27.185% |
| Tajikistan | Share of total exports | 1.987% | 0.801% | 0.007% | | 4.818% | 7.613% |
| Tajikistan | Share of CIS exports | 14.938% | 6.018% | 0.054% | | 36.217% | 57.227% |
| Tajikistan | Share of total imports | 10.838% | 1.631% | 3.501% | | 10.223% | 26.193% |
| Tajikistan | Share of CIS imports | 16.976% | 2.555% | 5.483% | | 16.012% | 41.026% |

However, in spite of relatively low international trade, it seems likely that individual markets for consumer goods in the region are highly integrated. Impact of border on price variation between Kazakhstan, Kyrgyzstan and

**Figure 5.2.**

Clusters of intraregional trade in the CIS, 2006

Notes: cluster analysis using Ward clustering method. Dissimilarity matrix defines dissimilarity as 1 minus share of trade turnover between countries i and j in the overall trade turnover of the country i in the CIS, prices of export applied

Source: own calculation based on CIS Statistical Committee database, 2007

Uzbekistan is relatively small and practically equivalent to the intranational price variation between individual regions (Grafe et al., 2005). It, however, does not imply that internal markets are integrated – only that the border effect for disintegration is less relevant. Therefore, one could probably assume that the integration on the level of small business networks is much higher, than for commodities (which play the crucial role in determining the structure of trade statistics presented above). Spechler (2000:7) claims that; “with all the problems, informal trade among the Central Asian countries appears to be working reasonably well”. Informal trade seems to be important for countries like Tajikistan (Olimova et al., 2006) and even Turkmenistan in spite of strong trade restrictions (in particular across the border with Uzbekistan) (Badykova, 2006). One should bear in mind, however, that the emerging informal trade networks often span outside the Central Asian region over the whole Eurasian continent (Evers and Kaiser, 2000; Kaiser, 2002).

Finally, the last issue to be considered is the labour migration in Central Asia. Once again, although Russia still remains the most important partner for the majority of the countries from the migration point of view, Kazakhstan plays an increasingly important role, partly competing with Russia. As in the case of the FDI activity, increasing labour migration in Kazakhstan is also a relatively recent phenomenon, directly related to the economic success of the country in the last half decade. The main countries of origin for labour migration to Kazakhstan are Uzbekistan (with a significant ethnic Kazakh minority) and Kyrgyzstan. Although Kazakhstan implements a policy of privileged ethnic

immigration of the *oralman* (ethnic Kazakhs), there seems to be a significant flow of illegal labour migration exceeding the official migration. The number of labour migrants from Uzbekistan in Southern Kazakhstan (which seems to be the most attractive region for migration inflows) varies between 200,000 and 1 million; however, the any data is likely to be extremely biased and is to be considered with great caution. Some authors point out the existence of labour migration from Uzbekistan to Kyrgyzstan, generating a remittance flow, but it seems to be relatively small (Mogilevsky, 2004:27). The migration flows have a heavy impact on both legal and illegal monetary flows of migrant remittances (Sadovskaya, 2005, 2006). In case of Tajikistan, Russia remains the absolutely dominant country from the point of view of labour migration. One can argue that for informal trade and migration, the “microregionalisation” involving selected regions and areas of the countries is probably relevant.

3. Regionalisation and institutions: channels of interdependence

However, the most important problem is not just to establish the existence and forms of regionalization, but also to understand its interconnection with the institutional development in the region. Regionalisation often occurs at the corners of the development spectrum: it can become crucially important for economies at the low level of development, substituting for the deficit of the rule of law, but it can also follow from high development, with high governance capacity of non-governmental agents. In both cases, the effects of regionalisation on institutions can differ. In Medieval Europe, for example, merchant guilds effectively supported the de-facto integration of the economic space and overcame the low development of formal institutions (Greif, 2006), but also engaged in redistributive activities and market monopolisation (Ogilvie, 2007). In what follows I am going to consider three channels of interaction between institutions and corporate integration.

3.1. Regionalisation and reform strategies

The first issue to be considered is the impact of models of institutional development in Central Asia on regionalisation. The countries of Central Asia experienced a variety of different reform strategies, and hence, economic outcomes and institutions. It is especially relevant for the two largest countries of Central Asia – *Kazakhstan* and *Uzbekistan*. As already mentioned, Kazakhstan is currently the centre of the process of regionalisation, especially within the framework of “investment model”, and significantly outperforms Uzbekistan. But why did Kazakhstan, and not Uzbekistan, generate the first regional multinationals?

From the point of view of formal institutions, Kazakhstan implemented a more consequent model of liberal reforms and high levels of openness for foreign investors (which recently was replaced by less favourable conditions for investors, who lost control of some important assets, and more important

industrial policy, say, within the framework of the cluster initiative). On the other hand, the structure of informal institutions, as in Russia and Ukraine, created a set of privileged business groups with strong economic and political ties (Libman, 2006). Uzbekistan did not implement any large-scale reform programme, maintaining significant public sector and public investments in the economy. Uzbekistan actually outperformed Kazakhstan in the early 1990s, giving rise to the discussions of the nature of an "Uzbek paradox" (Spechler et al., 2004). However, since the early 2000s, Kazakhstan has performed significantly better than Uzbekistan in terms of economic growth.

It is possible to claim that these differences to a certain extent explained the leadership of Kazakhstan, and not Uzbekistan, in the structure of investment integration. First, as part of liberal reforms of the banking system, Kazakhstan successfully transformed its banks into powerful players, which actually dominate in the process of regionalisation. Second, in a political-economic environment like that of the Central Asian countries, successful regionalisation basically requires two contradicting conditions. On the one hand, one of the problems of the state-led economies in a region with a very low level of political cooperation is that political difficulties actually prevent the development of economic ties. So, if the connection between economic and political actors is *formal* and *too strong* – like in case of the state-owned economy of Uzbekistan – political differences can effectively block any economic cooperation. On the other hand, an environment with poor protection of property rights is problematic for small private companies with substantial public support. The model of large privileged business groups implemented in Kazakhstan seemed to be quite successful from this point of view. Moreover, the businesses of this group are large enough to successfully establish their presence in neighboring states, but also have experience of turbulent economic environments, which gives them a unique advantage vis-à-vis multinationals from developed countries. Third, the timing of development seems to be crucial. Gradual reforms are likely to reduce pressure at the stage of recession, but rapid reforms and development of market institutions could lead to better performance *after* the recession stage. However, any regionalisation in the post-Soviet space became possible only after a certain period of time, when the initial problems of nation building preoccupying political elites became weaker. From that point of view, Kazakhstan also had better chances to become leaders of the regionalisation in Central Asia, than Uzbekistan.

The models of reforms and outcomes of economic development in other countries of the region also played a certain role in influencing the process of regionalisation in Central Asia. In some cases, the link is straightforward: for example, strict public control over all aspects of economy and society in Turkmenistan makes any active participation of this country in the regionalisation impossible; Russia's position in the resolving the civil war in

Tajikistan obviously supported the domination of large Russian multinationals in this country, although the current stabilisation of political regime has an ambiguous effect on status of Russian investors (Abalkina et al., 2007). Substantial informal trade and development of large migration flows is to a certain extent an outcome of economic problems of most countries in the region (with the exception of Kazakhstan) and strict public restrictions for formal trade (especially in Uzbekistan and Turkmenistan). Although the political instability in several countries of the region (in particular, in Kyrgyzstan) had a negative impact on FDI inflow (generally speaking, as well as from Kazakhstan), it is possible to claim that the Kazakh investors were *relatively* less affected by the problems than multinationals from developed countries (because of a general ability to act under weak institutions, as well as similarities in reform strategies between Kazakhstan and Kyrgyzstan, see Olcott, 2002; Spector, 2008). Hence, the instability, while having an *absolutely* negative effect on the investors from Kazakhstan, increased their *relative* weight. It is not impossible that there is also some *absolutely* positive effect; for example, in several regions of the CIS several groups of Russian investors were able to enter the markets *because* of low quality of institutions, but our analysis is limited to speculations.

3.2. Impact of Regionalisation on Economic Institutions

The opposite causal link – from the structure of regionalisation to the quality of institutions – is more difficult to study. The effects of regionalisation can be both strengthening the market-enhancing institutions and conserving the inefficient institutional structure. However, these effects also differ for the “investment driven” regionalisation and “informal trade” regionalisation. From the point of view of the investment driven regionalisation, two arguments should be mentioned. First, investment driven regionalisation (as well as developed labour migration) strengthens institutional competition, i.e. competition between countries for mobile factors of production by establishing legal environment and economic policies. Institutional competition is often considered to be an efficient tool of taming the Leviathanic rent-seeking government and of revealing the preferences for institutions through the evolutionary learning process (Vaubel, 2007). Secondly, multinationals are likely to act as channels of transmission of best practices and knowledge between countries; thus supporting the diffusion of efficient institutions. In a similar way, the best practices can be important through the networks of labour migration.

Unfortunately, both positive effects are not unambiguous. On the one hand, institutional competition is not necessarily driven by demand for good institutions. In fact, the literature on the post-Soviet transition established a variety of factors leading to inefficient equilibria supported by the demand for weak institutions (for a survey see Libman, 2007). This is definitively related

to the emergence and stability of the "clan capitalism" (Kosals, 2006) in the post-Soviet world. The main question is actually not whether demand for weak institutions really exists, but rather whether it is permanent (i.e. constitutes a stable equilibrium) or temporary (and after a certain period of development should be replaced by demand for good institutions). Havrylyshin (2007:17) refers to this discussion as "transition inevitable" and "transition frozen" school of thoughts and claims, that "the debate ... will certainly go on for some time to come". From the point of view of regionalisation in the CIS space, the results are ambiguous: both factors of demand for good institutions and demand for weak institutions seem to be present (Libman, 2007).

From the point of view of the Central Asian countries the problem is as ambiguous as in the CIS in general. Actually, it receives an additional dimension given relatively high degree of political instability in several countries of the region (like Kyrgyzstan and Tajikistan). It is clear that the increase of investments from Kazakhstan and Russia does not necessarily coincide with stronger demand for transparency and general rules in the Hayekian sense. In fact, the demand for privileged relations with regional authorities may be more important, and the "threshold level" of demand for institutions necessary to enter the market for the post-Soviet companies is not so high anyway. Hence, foreign investments may well support inefficient equilibria. Certainly they support the semi-authoritarian regimes in the countries of Central Asia, which, in turn, are one of the main factors of the existing low quality of governance (Libman, 2007a). Moreover, as already noticed, strengthening these regimes can effectively result in a hold up of foreign assets and decline of regionalisation in general. However, the alternative to this support may be not market-enhancing reforms (like in the countries of the Western flank of the CIS), but chaos and disorder.

Similar reasoning is applicable for the second channel of impact of regionalisation on the quality of institutions. In fact, in spite of its own institutional deficits, Kazakhstan can become an important source of "good practices" for the countries of the region. Once again, unlike the Western flank of the CIS, there are hardly any viable alternatives (like investments of multinationals from developed countries). Nevertheless, this transmission of good practices is per se limited by the quality of institutions in the country of origin of investments, making the very issue of institutional advancements crucially dependant from reforms in the leading country. Given the extremely brief experience of investment led regionalisation in the region, it is still difficult to make any conclusions. Moreover, effects can be different for different business groups with their own strategies of business-government relations.

The effects of informal trade regionalisation are also not unambiguous. As already mentioned, most forms of the informal regionalisation appear in an environment of weak formal institutions; to a certain extent, they serve as an

instrument of overcoming this problem. From this point of view, informal trade networks serve as a natural instrument of establishing an order for economic transactions. However, in this case their advantages and disadvantages are similar to the general discussion on the role of informal economy: on the one hand, it overcomes the deficits of formal rules and makes economic transactions possible, but on the other hand, informal rules are less efficient (e.g. because of their personalised nature vis-à-vis formal abstract rules) and, more importantly, they establish behavioural patterns preventing introduction of formal rules in the future. A possible strategy in keeping with the ideas of Hernando de Soto is to develop formal rules consistent with informal rules, but it is always a difficult task (also from the point of view of incentive-compatibility for political decision makers). Therefore, the existence of informal trade regionalisation may constitute a constraint optimum in a given environment, but is able to become an obstacle for the development of efficient reforms in the future.

3.3. Regionalisation and regionalism

The last point I address in this paper is the relation between regionalisation and regionalism. As already noted, there have been numerous attempts of top-down integration in Central Asia, mostly without any visible results. Even the most basic form of regional cooperation – the Free Trade Agreement (FTA) – is quite problematic. Although there exists a (highly incomplete) network of bilateral trade agreements in Central Asia (Kort and Dragneva, 2006:9), there are huge implementation problems; countries quite often act unilaterally, restricting the trade relations in case of economic or political turbulences. However, regional integration, both in the context of larger regional agreements like EurAsEC or SCO and specific structures for Central Asia (Kuz'min, 2008) remains part of the agenda in the region. Once again, investment led and informal trade regionalisation can have different influences on the regionalism in Central Asia.

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

Considering the link between investment-led regionalisation and regionalism, one should not forget the potential importance of political institutions in the regional integration processes. As noted, most countries of the region are semi-authoritarian regimes, where governments use the design of economic institutions to restrict potential opposition. It is well known in the literature on international integration, that non-democracies are less likely to participate in the regional economic integration than democracies (Mansfield et al., 2002). In fact, that is what one can observe in Central Asia: the less democratic countries of the region (Turkmenistan and – to a lesser extend – Uzbekistan) are also less likely to become part of integration agreements. The main problem is the issue of commitment: in a political system based on informal power balances, it is extremely difficult to provide any commitment to an external actor, yet alone to give up part of the sovereignty (what is per definition implied by the regionalisation). The question is, of course, whether regionalisation can overcome these obstacles. Basically, there are two factors to be taken into consideration. First, regional cooperation can take form of the development of *international hierarchies* (Lake, 2007), and in this case is less dependent from the issue of democracy. An important aspect from this point of view is not just the *existence* of asymmetries, but also the *scope* of asymmetries. Weak asymmetry can in fact be even quite dangerous for regionalism: it increases mistrust, but does not provide any instruments for leverage. In fact, the political elites in Kyrgyzstan have been quite cautious with respect to any potential integration with Kazakhstan. However, high levels of political instability is a clear factor increasing the asymmetries and also the demand for international hierarchies. Second, the question is whether there is a clear link between investment expansion and governmental policies. Once again, in the case of Russian investments in Ukraine, businesses basically ignore the regionalism dimension. However, given a relatively high influence of consolidated political leadership in Kazakhstan on its business groups, one could in fact expect that the government will be able to influence the investment decisions following the logic of international politics. Hence, one can actually expect that in case of Kazakhstan and Kyrgyzstan *regionalisation could support formal regionalism*.⁴

Obviously, the scope of these projects mostly covers Kazakhstan and Kyrgyzstan, and maybe Tajikistan (where the position of Russia is crucial). Uzbekistan has been quite reluctant to support regionalism in Central Asia (Bohr, 2004; Kuz'min, 2008), and in the current situation seems to prefer Russia to Kazakhstan as the main source of FDI, designing its investment

⁴ It is important to notice, that the main players in the economy of Kazakhstan are, though highly connected to the government, still private businesses. There is no trend towards wide-scope nationalisation in Kazakhstan, as it was observed in Russia. This is an additional argument in favour of the regionalism projects: in case of dominance of state-owned enterprises regionalisation can effectively become just another form of intergovernmental contacts (Vinokurov 2008).

policies respectively (Abalkina et al., 2007; Heifetz and Libman, 2008). The latter fact raises an important issue of *competition between Central Asian regionalism projects and broader projects* (with participation of Russia – EAEC – or China – Shanghai Cooperation Organisation). And in this context, the development of regionalisation can also be quite important: on the one hand, strong economic interconnections can make regional integration within Central Asia a priority; but on the other hand, it is possible, that at least some actors try to off-balance economic influence of Kazakhstan by the political influence of other actors (e.g. Russia). Theoretically, it is also reasonable to claim that *the development of Central Asian regionalism is able to reinforce the regionalisation*, reducing the degree of political uncertainty and removing existing borders. The crucial factor is here whether the regionalism will move from rhetoric to implementation. The effects of pure rhetoric (as it has been so far in the field of regionalism in Central Asia) are ambiguous: it can both create necessary framework for public support of investment expansion (as seems to be the case for Kazakhstan-Kyrgyzstan dyad [Kuz'min, 2008]), but also introduce political tensions in purely economic relations.

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

4. Conclusion

In this paper I tried to show that there are at least some elements of regionalisation present in Central Asia, though their role is still relatively limited. The businesses of Kazakhstan have recently significantly increased their presence in the economy of Kyrgyzstan, particularly in the banking sector. Currently, state-owned structures (KazTransGaz, Kazyna) and the government of Kazakhstan increase their attention to the support of

investment expansion: Kazyna participates in the development of a mutual investment fund of Kazakhstan and Kyrgyzstan; a similar institution was established for Kazakhstan and Tajikistan. However, the investment expansion of Kazakhstan is a very recent phenomenon of the last years – even opposed to Russia's business expansion starting in the early 2000s. Moreover, a complex network of informal trade, which is only partly captured by statistics, links Kazakhstan, Kyrgyzstan and Uzbekistan. This is a very old phenomenon, which is based on traditional economic ties in the region and which exhibits a higher level of development than in the CIS in general (with the only exception of unrecognised republics, where informal trade is also important). Given the significant size of the shadow economy in Kazakhstan (Schneider (2007) estimates it at 44.6% of official GDP for 2004/05), Kyrgyzstan (40.6%) and Uzbekistan (35.4%), the role of informal trade should not be underestimated. Less reliable estimates of shadow economy in Tajikistan exceed 60% of official GDP (Lenta.ru, 2007, June 27); this country is also involved in the structure of informal trade, but generally is to a greater extent connected to Russia than to the subregional regionalisation processes. The role of Turkmenistan seems to be negligible. Probably, it is more justified to consider the informal integration of Central Asia as a network of areas of microregionalisation, which may have relatively limited ties between each other.

The patterns of regionalisation seem to be heavily influenced by the development of institutions in Central Asian countries. In particular, the model of more liberal reforms combined with still-persistent links between influential business groups and politics seems to be a "success combination" for the multinationals from Kazakhstan (as opposed to Uzbekistan). The impact of regionalisation on institutional development is, however, ambiguous: on the one hand, it can serve as a link for transmission of "best practices" and reinforce better property rights, but on the other hand, the positive impact is limited by institutional deficits for the economy of Kazakhstan. Finally, regionalisation *could* potentially support the regionalism development in Central Asia, though the expectations are also unclear. The informal trade model seems to be relatively stable; it is hardly possible to expect qualitative shifts in the design of formal institutions reducing the attractiveness of informal channels.

Since the investment integration in Central Asia (a relatively recent process), it is difficult to make clear predictions regarding the future of the regionalisation. It is probable that the investment and migration flows crucially depend on economic performance of Kazakhstan. Recent turbulences related to the global financial crisis 2007-2009, which seems to have had a significant impact on the banking system of Kazakhstan (the driving force of FDI regionalisation!), raising some questions regarding the viability of the model. Therefore, the coming few years could be quite interesting from the point of view of informal regional integration in Central Asia.

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