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Openness and isolation: The trade performance of the former Soviet Central Asian countries

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ABSTRACT

Previous studies divide the former Soviet Central Asian countries (CACs) into "more open" (Kazakhstan, Kyrgyzstan) and "more isolationist" (Tajikistan, Turkmenistan and Uzbekistan) depending on their trade-to-GDP ratio. We investigate this by gravity analysis measuring contributions of country-specific properties and networking factors in 185 bilateral CACs trade flows over the period 1995–2011. Our findings suggest that while all CACs have experienced growing trade over the period, they show considerable variety in initial conditions and transition reforms. The more isolationist countries have mostly relied on fortuitous factors such as hikes in natural resource prices to boost their trade, whereas the more open, reform-minded states have achieved considerable trade growth through reducing trade costs. Being an open or isolationist economy has resulted, respectively, in more or less suitable environment for business and investment.

1. Introduction

While much of the literature on post-Soviet transition has focused on the experiences of the countries in Central and Eastern Europe and the Russian Federation, the Central Asian countries (CACs) have received relatively less attention[2]. There is no study focusing on the trade determinants and performance of CACs, even though it has been recognised that there is a strong correlation between success in transition from plan to market and foreign trade performance (Kaminski, Wang, & Winters, 1996). In addition, the international business (IB) literature has not paid enough attention to the developments in Central Asia after the disintegration of the Soviet Union and there is no study focusing on the business environment in CACs and their trade performance[3].

Much of the existing (economics) literature has tended to treat the CACs as a relatively homogenous region. However, after more than two decades of independence, important differences are emerging. In terms of trade performance, the trade/GDP ratio over the period 1995–2011 is much higher for Kazakhstan and Kyrgyzstan (38% on average) than for Tajikistan, Uzbekistan, and Turkmenistan (26% in average). This ranking also corresponds to that in the 2013 World Bank "Doing Business" report, which reflects the ease of doing business, tax collection, investor protection, access to credit, trading across borders, corruption, economic freedom, and competitiveness. Kazakhstan (49th out of 183 countries) is the highest ranking CAC, followed by Kyrgyzstan (70), Tajikistan (141), and Uzbekistan (154) while Turkmenistan is not ranked at all. This perhaps illustrates the close ties between trade openness and overall politico-economic reforms.

The standard transition literature emphasises a combination of initial conditions and the reform policies adopted during the transition period (Falcetti, Lysenko, & Sanfey, 2005 present a good review). Both initial conditions and, especially, reform policies vary substantially. Trade performance clearly reflects, in part, initial conditions, such as resource abundance, geography, transport infrastructure, specialisation, colonial ties, and so on (Elbourgh-Woytek, 2003; Grigoriou, 2007; Levy, 2007; Pomfret, 2011; Sinitsina, 2012; Suvankulov & Guc, 2012) as well as national business culture (Buck, Filatotchev, Demina, & Wright, 2000; Dow & Karunaratna, 2006; Wu, Li, & Samsell, 2012) or corporate

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[1] The paper draws heavily on Arman Mazhikeyev's doctoral research; nevertheless, the authors' contributions to this paper are equal.

[2] Some notable exceptions are Rumer (1995, 2000a, 200b), Pomfret (2000, 2003), Burghart and Sabonis-Helf (2004), Starr (2004), Hausmann, Hwang, and Rodrik (2005), Dowling and Wignaraja (2005, 2006), and UNDP (2005) which focus on general economic development and political issues.

[3] The IB literature has a few examples of papers on disintegration and rebuilding of networks between former Soviet republics (e.g., Davis et al., 1996), but these papers are now rather old. Pittman (2013) covers Central Asia, but from the limited perspective of transport system restructuring.

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governance (Filatotchev, Wright, Uhlenbruck, Tihanyi, & Hoskisson, 2003). These are quite heterogeneous, as we discuss below. However, there is also a strong contrast in terms of reforms enacted since the mid-1990s, as measured by the EBRD transition indicators (Stark & Ahrens, 2012). It is not easy to disentangle the effects of varied initial conditions from those of ongoing reforms, and this is made even harder by a changing global and regional environment which impacts the different players to varied degrees (Levy, 2007).

In the paper, we develop an IB-inspired theoretical framework to motivate hypotheses and investigate which factors are more important for each individual CAC by measuring the proportional share of country-specific properties and networking factors in bilateral trade flows. We do this by utilizing the gravity concept (e.g., Head, Mayer, & Ries, 2010; Zwinkels & Beugelsdijk, 2010), which explains bilateral trade in terms of country "masses" (country properties) and "distances" (networking). From the previous literature in the field, we would anticipate that these countries are all relatively isolated from the rest of the World. However, Pomfret (2010) has indicated that some of these countries have started engaging in serious reforms, while others are much slower—we will be seeking evidence in support of this. We therefore expect that these countries are more heterogeneous than the previous literature has recognised. In addition to documenting this heterogeneity, we would identify factors impacting trade, and link policy reform to trade performance and business development.

In terms of the detailed econometric work, by taking a ratio of the ratios of bilateral trade, we can separate country-specific from networking (bilateral) factors. Our analysis of 185 CACs bilateral trade observations, based on a 37 country panel covering the 1995–2011 period shows that: (i) networking factors explain 50% or more of changes in Kazakhstan's and Kyrgyzstan's trade flows and 5–14% of changes in Turkmenistan's, Uzbekistan's and Tajikistan's trade; (ii) 75% of changes in the 185 bilateral CACs' trade flows are mainly explained by country specific properties, i.e., monadic driven trade; (iii) 25% of the 185 bilateral CACs' trade flows are explained by networking (bilateral) factors such as transport costs, combined with landlockedness and RTAs, i.e., dyadic driven trade; (iv) open CACs are more sensitive to global and regional shocks compared to isolationist CACs.

2. Context, theory and hypotheses

2.1. The CACs context

All the CACs became independent in 1991. Similarities in initial conditions reflect their history, geographic closeness and cultures. CACs populations originate from the same Turkic tribes. Historically, all were colonised by Tsarist Russia and belonged to the Soviet Union for over 70 years. All geographically landlocked, CACs differ in terms of neighbours, land sizes and landscape, size of population, endowment of natural resources, and historic production specialisation. Kazakhstan possesses the largest territory, borders with Russia and China and has relatively better rail and road connections left from Soviet times. It is well endowed with oil, coal, metals and agricultural land. By contrast, Kyrgyzstan and Tajikistan are mountainous, smaller in size and population and have mountain borders with China and Afghanistan. Uzbekistan has a relatively large population, possesses substantial natural gas reserves and good conditions for cotton production. Turkmenistan is much more sparsely populated, but well-endowed with natural gas.

Pomfret (2005) among others concludes that transition reforms proceeded faster in Kyrgyzstan and Kazakhstan and slower in Tajikistan, Uzbekistan and Turkmenistan. EBRD transition indicators show a similar ranking in terms of privatisation and price liberalisation—policies which are an important stage of ongoing transition reforms (Barlow & Radulescu, 2005; Stark & Ahrens, 2012). Although Uzbekistan did well with price liberalisation in the mid-1990s, it kept enterprises under state control and has been slow with other reforms. Gas-rich Turkmenistan has been reluctant to make substantial changes in its economy, although after the death of the president Nyazov in 2006 the country has begun to liberalise. Tajikistan went through a civil war (1992–1997) and since then has been slow to implement reforms.

The CACs faced huge trade and production hardships with the Soviet collapse and subsequent hyperinflation in 1991–1996. Within a year of independence trade with Russia fell tenfold (Sinitsina, 2012). Later, in 1998–1999, the CACs were hit by the Russian financial crisis. Despite these circumstances, countries were already beginning to diverge in terms of international integration—particularly, though not exclusively with Russia. Already by 1998 Kazakhstan, Kyrgyzstan and Tajikistan had joined several major RTAs with Russia, including the CISFTA in 1994, EurAsEc and SCO in 1996 while Uzbekistan and Turkmenistan were only observers (see Appendix). The CACs' trade with Russia was damaged substantially by the 1998 crisis, especially those countries which had engaged in integration (Westin, 1999). The more isolationist Turkmenistan and Uzbekistan had less exposure. The period 2000–2007 was more fruitful as world prices for the CACs' primary export goods (oil, gas, cotton) accelerated and volumes of trade and FDI inflows, mainly from China and Europe, increased. The main beneficiaries were the more open economies, but Uzbekistan and Turkmenistan also benefited from a global boom and increasing global gas demand, negotiating with China and Iran to reduce their dependence on the Russian market. The 2008 crisis had both direct and indirect effects on the CACs' trade and economic wellbeing. The exposure of Kazakhstan's banks to the global financial crisis spread to Tajikistan and Kyrgyzstan. Uzbekistan and Turkmenistan which had more limited financial links with the other CACs, Russia and rest of the world where originally less affected by the crisis.

2.2. Theory and hypotheses

2.2.1. A game tree of openness and trade: Actors and interactions

The degree of openness or isolation of an economy can be seen as the outcome of the interaction of decisions of a number of actors in response to their environment and to each other. The principle *actors* in any economy constitute consumers/voters, government, MNEs and local firms: however, we should also note that the specific post-Soviet environment tends to include important roles for ethnic (particularly Russian) minorities and for the politically-connected oligarchs who rose during and just after the fall of Communism. Broadly speaking, Fig. 1 shows a game tree outlining the interactions of these actors.

Trade *policy* is set by the governments, and may take the form of multilateral liberalisation or regional integration (the latter being increasingly favoured by the intended development of the Eurasian Union). Governments also set the regulatory environment governing trade and FDI, and have influence on the legal environment, as well as influencing the quality of transport linkages and border efficiency. The presence of multinational agreements and RTAs shows that governments interact with one another: particularly their neighbours (and the rest of the world).

At the same time, however, the *trade performance* of an economy depends upon the decisions of other actors (at micro level), notably firms. If the larger local firms and MNEs respond to liberalisation by expanding trade greatly, then the country will see an increase in competition and specialisation gains from trade, in turn benefiting consumers. The more elastic is firms' response, the less will be the 'beggar-my-neighbour' incentive of a country to