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Political economy of financial reforms in authoritarian transition economies. The case of Kazakhstan and Uzbekistan

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Abstract

Since dissolution of the Soviet Union, Uzbekistan and Kazakhstan adopted different approaches to economic reform, particularly in financial sector. Uzbekistan has adopted gradual reforms with minimal liberalisation whereas Kazakhstan embraced bolder reforms with extensive privatisation and liberalisation in the real economy and financial sector. The impact of reforms varied with lower decline and quicker but more moderate recovery in Uzbekistan. In contrast, Kazakhstan has experienced longer and deeper decline but with greater growth rates in 2000s. The chapter discusses the political economy of reforms in these two countries, which share close geographic, demographic, and cultural ties as well as authoritative way of political management. It attempts to analyse the reasons for differing approaches and examines the outcomes of reforms in light of recent/current global financial crisis.

Key words: Financial Reform, Transition Economics, Kazakhstan, Uzbekistan, Political Economy, Dictatorship

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1. Introduction

Ever since the collapse of Eastern (communist) block in late 1980s and early 1991s, and declared transition towards western style of democratic and market institutions, a large scope of research and policy advice has been directed towards studying of so called transition economies. Now, over two decades after the commencement of transition process, countries that started the process show a great diversity of progress. Some, mainly in Eastern Europe, were able to develop democratic and market institutions similar to their Western European counterparts. In contrast, there is a range of highly autocratic regimes with political and /or market institutions hardly nearer to western democracies/markets than at the start of transition. The level of economic development also varies significantly; however does not perfectly correlate with level of development of western institutions in the respective countries. The case study of one example of such a conundrum is an aim of this study.

The approach to economic reform in transition economies, including scope, speed and sequencing, or more broadly gradualism vs shock therapy, has been generally framed by scholars Rodrik and Roland to what is known as political economy of transition (Rodrik 1993; Roland 1994, 1997, 2000, 2002). The theory discussed ex-ante and ex-post political constraints for reform acceptability and reform reversibility respectively, and the ways to overcome those constraints (Akimov, A. & Dollery, B. 2008). The framework has proved to be valid and useful in the analysis of many transition countries, particularly in Eastern and South Eastern Europe. It implicitly assumes strive for development and economic growth coming from the general population, which has an ability to influence the decisions of their policy-makers through democratic election process. However, it does not seem to be particularly useful in the analysis of reforms (or their lack) in countries, where post-communist regimes turned authoritarian. By the end of 1990s, all Central Asian regimes of former Soviet Union could be classified as authoritarian albeit in the varying degree (Jones Luong, Pauline 2002b).

The implementation of any reform program in authoritarian countries in either the real or the financial sector depends critically on the political will of national leaders. The financial system in any country thus cannot be analysed comprehensively in an institutional 'vacuum' without detailed consideration of the political environment, economic progress and other institutional issues.

The aim of the paper is to examine financial reforms in two countries of post-communist Central Asia, which share common Soviet past, have close geographical location, cultural, language and religious ties. Yet, their approach to economic reform was rather different. As a consequence, outcomes of those reforms varied. The difference is especially noticeable in the aftermath of the global financial crisis (GFC). In this paper we attempt to link the theoretical literature on political economy of reforms in authoritarian countries with approaches taken by Uzbekistan and Kazakhstan leaderships.

The rest of the chapter consists of four main sections. Sections 2 and 3 discuss political and economic developments in Uzbekistan and Kazakhstan respectively over the last two and half decade. Section 4 provides comparative analysis of the reforms from a political economy of dictatorship point of view and attempts to classify the nature of the regimes in the respective countries within existing frameworks. The chapter ends with the conclusion in Section 5.

2. Political and economic developments in Uzbekistan from the period of before Independence to after GFC

2.1 Introduction

The Republic of Uzbekistan (or simply in short Uzbekistan) is a landlocked country located in Central Asia. Uzbekistan comprises 447,400 square kilometres. It stretches 1,425 kilometres from west to east and 930 kilometres from north to south. It shares a border with four other post-Soviet republics of Central Asia and Afghanistan in the south. It is only one of two 'double-landlocked' countries in the world, which means that all the countries it borders on are denied direct access to the sea.

The population was estimated to be 28.9 million persons in 2014, with an annual growth rate is around 0.9 per cent. The population is rather mono-ethnic with 80 per cent of population are ethnic Uzbeks. Others large groups include Russians (5.5%), Tajiks (5%), Kazakhs (3%) and others. Since 1991, there has been a substantial emigration of the non-Uzbek populations (mainly Russians, Ukrainians and Tatars). Around 74.3 per cent of population consider the Uzbek language as their mother tongue, 14.2 per cent Russian, and 4.4 per cent the Tajik language. The official language of Uzbekistan is Uzbek. About 88 per cent of the population regard themselves Muslims, around 9 per cent Russian Orthodox and remaining the people are mostly Jews and various Protestant denominations (Central Intelligence Agency 2014b).

Although Uzbekistan is well-endowed with mineral resources, including natural gas, gold, copper, lead, tungsten, uranium, zink and oil, it is considered as a lower middle-income country with a GNI per capita of USD1720 in 2012 (World Bank 2014b). Its major trading partners are Russia, Kazakhstan, China, South Korea, Germany and Turkey.

2.2 Period before Independence

Pre-independent political and economic environment in Uzbekistan largely reflected general trends in the late stage of the USSR. With the introduction of Gorbachev's 'perestroika' and 'glasnost', criticism of Moscow policy towards Uzbek Soviet Socialist Republic (UzSSR) were raised. Rafik Nishanov, First Secretary of Communist Party of UzSSR in 1988-1989, cited the 'cotton monoculture' as a

problem that constrained economic growth in the Republic as well as a curse that had brought horrendous ecological disaster in the form of Aral Sea desiccation.

Political reforms in the Soviet Union were also reflected in the political landscape in the UzSSR. Nishanov was promoted to Moscow and Islam Karimov was appointed in his place. A number of legislative documents were adopted by the Supreme Council making amendments to electoral laws and granting wider powers to the various republics' authorities.

The same time, Karimov did not support many of Gorbachev's policy initiatives and opposed the tendency of slow dissolution of the Soviet Union. In 1991, he supported Soviet referendum to maintain a unified country and was also sympathetic to the so-called 'August coup', which attempted to reverse break-up of the USSR.

However, when the coup failed, he reacted decisively to a changed political landscape and Uzbekistan proclaimed its independence. On 8 December 1991, the leaders of Russia, Ukraine and Belarus signed the agreement for the creation of the Commonwealth of Independent States. Shortly after, Uzbekistan joined the new formation. At the end of December, Gorbachev officially resigned as President thereby officially ending the formal existence of the Soviet Union.

Faced with the imminent collapse of the Soviet Union, leadership in Uzbekistan began to consolidate its power. At first, the Uzbek Communist Party decided to separate from the Soviet Communist party. Moreover, it changed its name to the Peoples-Democratic Party of Uzbekistan (PDPU) and confirmed Karimov as its leader. The secret service and police forces (i.e. militia) were both nationalised and subordinated to Karimov.

Four days after resignation of Gorbachev as the Soviet President on 25 December 1991, a referendum and presidential elections took place in Uzbekistan. The referendum confirmed the already *de facto* independence of Uzbekistan from the Soviet Union. In the presidential elections, in which two candidates competed, Karimov won with an overwhelming majority of 86 per cent over the opposition candidate from the *Erk* (Freedom) Party – Muhammad Solih. Another opposition *Birlik* (Unity) Party had been refused registration and had thus not been able to nominate its candidature for the elections.

The structure of the economy in the UzSSR was dominated by agriculture, particularly cotton-production and related industries. Agriculture contributed 40 per cent to the Republic's net material product, whereas the share of industry, construction and services was 33 per cent, 14 per cent and 13 per cent respectively. Major agricultural products were cotton about 40 per cent, silk, wool, fruit and vegetables. Most industrial production served agriculture (i.e. production of cotton harvesters and textile machinery, textile and food processing industries, and the production of fertilisers in the chemical sector). Other important industrial production included mining, aviation and excavator-producing plants (Islamov 2001).

Uzbekistan was second poorest republic of the former USSR, after Tajikistan. For instance, its per capita income amounted to only 67 per cent in 1980 and 62 per cent in 1988 of the Soviet average. Retail price inflation in the Soviet Union was below 2 per cent per annum over the 1980s. However, it rose in 1990, and especially in 1991, when the Soviet government introduced the first price liberalisation. It became more significant in the early years after Independence.

Following its Independence in 1991, Uzbekistan had to deal with its economic problems and proceed with reforms itself. From the outset, the Uzbek government confirmed its commitment to build a democratic state with a market-economy. It initially chose the so-called 'Turkish model' of development. However, shortly after, the authorities started to promote their policies as their 'own way of progress and revival for Uzbekistan' (Karimov 1993, 1995). In practice, this meant a more gradual approach to the reforms than the ones implemented in a majority of other post-communist countries. Three broad stages can be identified in Uzbekistan's economic development since independence. The first stage, which extended over 1992-1996 has been recently described as 'the Uzbek paradox' by Pomfret (2006). The second stage over the period of 1997-1999 can be termed 'Reform reversals'. The final stage covers a period since 2000, which I would call 'Ad-hoc developments'.

2.3 Early years of Independence, 1991-1996

1992 represented a year of building 'national statehood' – Uzbekistan obtained its national symbols and become a member of the UN and other international organisations. Moreover, the Constitution was adopted. The Constitution confirmed Uzbekistan as a secular state and it enshrined the rule of law, freedom of conscience and religion, press freedom and democracy. The Constitution stipulated the establishment of a three-tiered power structure: executive, legislative and judicial. However, the executive branch, headed by the President, was granted superior powers over both the legislature and the judiciary. For example, the President had the right to dissolve the Parliament, whereas the Parliament could not dismiss the President. Moreover, the President was empowered to appoint the Prime Minister and all ministers. The judges of the three national courts were also appointed by the President subject to the approval of the Parliament. The presidential term in office was set to run for five years.

The functions of the Parliament had been exercised by the Supreme Soviet inherited from the Soviet times and dominated by the PDPU members. It functioned until December 1994, when first Parliamentary elections were held under a new Constitution.

Since 1992, the PDPU enjoyed dominance in both executive and legislative powers. All influential opposition groups were repressed or physically discouraged by the President-controlled police and intelligence services. The two most powerful opposition parties, *Birlik* and later *Erk*, were banned and their leaders fled the country

under threat of arrest. The Vice-President, Shukurullo Mirsaidov, a representative of the influential 'Tashkent clan', was arrested with 'abuse of power' charges after an attempt of overthrow Karimov. After the elimination of the secular opposition, Karimov started a crackdown on Islamic groups that threatened to overthrow the secular state in Uzbekistan. Moreover, he strongly supported the secular leadership in Tajikistan in the civil war against Islamic opposition during 1992-1997 (Akimov & Dollery 2009b).

In the first post-Independence Parliamentary elections, the PDPU continued to enjoy dominance by securing 189 seats in the 250-seat Parliament. The only other political party (also pro-government) that was allowed to participate was the *Vatan Taraqqiyoti* Party (Progress of Fatherland party). As a result, Karimov was ensured full support for all his actions for a second term (Inter-Parliamentary Union 2014).

One of the notable initiatives of the new Parliament was to call a referendum in March 1995 in order to extend the President's first term in office (ending in 1996) until 2000. As expected, an absolute majority of around 99 per cent voted for the extension. The same year, under the pressure of the international community, Karimov announced a policy of tolerance in respect of opposition parties and movements. In practice, a number of new 'petty' parties were created, which could afford to slightly criticise the government, but never the President.

It is important to note here that despite the referendum having been undemocratic in many ways, Karimov enjoyed a broad popularity among citizens. The maintenance of peace and stability, the restraining of organised and other crime, as well as continued social support, were credited to Karimov's achievements. This referendum was pivotal point in Uzbekistan's political landscape. That is when Karimov finalised his complete dominance in Uzbekistan's power hierarchy.

The economic policies in early independence years were primarily directed towards price liberalisation, inflation control and privatisation but maintaining reasonable level of social protection (Sirajiddinov 2004). From the outset, the Uzbek government was reluctant to follow 'big-bang' reforms introduced in Poland and then Russia and Kazakhstan. However, it had to follow wide-spread price-liberalisation introduced in Russia since it remained in the rouble zone. To avoid possible social unrest, prices for some essential goods, like basic food-stuff, utilities and transport, remained subsidised (though regularly adjusted for inflation). As a result of price liberalisation, hyperinflation took off to three-four digit levels over 1992-1995. With no macro-economic instruments to counteract inflation, Uzbek leadership decided to introduce a temporary (in November 1993) and then permanent a national currency (in July 1994). Through a range of monetary and fiscal measures, inflation started to slow down from the second half of 1994. The government introduced a managed floating exchange rate regime for the national currency and somewhat relaxed access to foreign currency.

The privatisation policy in Uzbekistan has been very gradual and was planned to proceed in three stages. The first stage took place during 1992-1993 and was largely successful. All housing as well as small businesses, primarily in the services sector, were privatised. During the second stage, which was named 'mass privatisation', the remaining small enterprises, a majority of medium and some large enterprises were to be privatised (Chjen 1996). The success of the second stage was mixed. On the one hand, privatisation of small businesses was largely complete and many medium enterprises were *de-jure* privatised. On the other hand, the government was reluctant to sell large enterprises. Moreover, it continued to interfere in the affairs of the privatised companies. The third stage was supposed to take place from 1996 with de-nationalisation of the majority of large remaining enterprises. However, this was implemented only partly. The number of enterprises for sale was reduced and the speed of privatisation was substantially slower than initially planned. The government retained control over land and natural resources.

The reforms in the banking sector started in 1991, when a two-tier banking sector was established. Former branches of the specialised banks of the Soviet Union smoothly evolved into commercial banks in Uzbekistan and the Central Bank was established in place of the UzSSR branch of Gosbank. Capital markets were initiated in 1994 when a stock exchange was founded. This was mainly to support privatisation efforts. Several legislative enactments were adopted to regulate the market (Akimov & Dollery 2006).

To counteract shortages of consumer goods, the Uzbek leadership initially pursued a very open foreign trade policy for imports. Non-tariff import restrictions were absent and import tariffs were very low (5-10 per cent). Simultaneously, to prevent an outflow of locally produced goods, export tariffs and several import quotas and licenses were introduced as from November 1992 (Sirajiddinov 2004). Moreover, Uzbekistan's major exports of cotton, some non-ferrous metals and fertilisers remained under the state's control. The export taxes became a significant hard currency revenue source in 1992 but less so in 1993. These revenues were used to subsidise sales of some essential consumer goods imported from abroad (Pomfret 1995). Since 1994, trade liberalisation was extended and all import duties were lifted, while non-tariff export restrictions started to be phased out by export tariffs.

To counter high levels of budget deficit, reforms in taxation system took place with introduction of various indirect taxes and revision of income tax rates. Tax collection has improved and social programmes revised to improve their efficiency. These measures helped to further reduce the budget deficit in 1994-1995 (European Bank for Reconstruction and Development 1999).

Uzbekistan performed reasonably well in terms of output after 1991. The largest GDP decline of -11.2 per cent occurred in 1992. During 1993-1995, the decline slowed down and in 1996, growth started again. The savings rate dropped dramatically to a low 3.7 per cent in 1992, but then went on to recover to reasonable levels in the later

years. An active public investment policy improved investments rates to a reasonable 25-30 per cent of GDP during 1995-1996. However, foreign direct investment never really took off during the period with the highest level of a tiny 0.6 per cent registered in 1994. The official unemployment rate stayed very low, but in reality unemployment could have been higher due to lack of adequate benefits for registering as unemployed. The main economic indicators over the period 1992-1999 are presented in Table 1.

Although Uzbekistan was a slower reformer, an important feature of the reforms was their efficient implementation. Uzbekistan's quality of governance could be favourably compared not only to other CIS countries, but also with several Eastern European countries. Public investments projects, although often ineffective, provided a 'bumper' for the output decline during the period.

Table 1. Main economic indicators 1992-1999

Indicator	1992	1993	1994	1995	1996	1997	1998	1999
GDP growth, %	-11.2	-2.3	-5.2	-0.9	1.7	5.2	4.3	4.3
GDP per capita ¹	578	553	514	500	499	515	528	543
GDP per capita ²	1343	1310	1243	1233	1257	1328	1371	1435
Domestic savings/GDP	3.7	17.8	14.5	27.1	22.7	18.7	16.5	17.3
Investments/GDP	19.8	14.6	18.3	27.3	29.2	21.7	20.9	17.5
FDI/GDP (%)	0.0	0.4	0.6	-0.2	0.0	1.1	0.9	0.7
Inflation (GDP deflator, %)	712	1079	1239	371	82	66.1	39.0	44.1
Budget deficit (% of GDP)	-18.4	-10.4	-6.1	-4.1	-7.3	-2.4	-3.0	-2.6

¹ Constant, year 2000 USD

² PPP method; in USD

³ 1989-2000 for GDP growth

Source: European Bank for Reconstruction and Development (1997, 1999); World Bank (2014a)

2.4 Tightening the control and reform reversals, 1996-1999

With suppression of official opposition (both secular and Islamic), unregistered Islamic radical movements started to gain some support. Simultaneously, these became a main focus of government repression (Economist Intelligence Unit 2005). A radical group – Islamic Movement of Uzbekistan (IMU) organised a number of violent attacks in various Uzbek regions as well as two invasions of militant groups from remote parts of Tajikistan and Kyrgyzstan. The insurrections were defeated by military forces, but not without difficulty. Although the IMU had considerable support from the *Taliban* and some Islamists in Tajikistan, it had little support in Uzbekistan itself. The attacks were used as a justification for the widespread oppression of members of various independent Islamic networks and their families. Moreover, the exiled *Birlik* and *Erk* party leaders, charged with the connection with the bombings, were sentenced to long-terms of imprisonment *in absentia*.

In 1999 and 2000, the second round of parliamentary and presidential elections took place. In the 1999 parliamentary elections, representatives of five (pro-government) parties were elected, including PDPU. Many elected deputies were bureaucrats who used administrative power to secure success in their election campaigns. In January 2000, Presidential elections were conducted with two candidates running for the presidency. One of the candidates was Karimov - who was nominated by the newly established *Fidokorlar* (Patriots) Party². The other candidate was Abdulhafiz Jalolov – the leader of the PDPU. The elections were unjust since many voters only learnt about the existence of a second candidate on the day of elections. Moreover, in order to avoid any post-election repression Jalolov officially declared that he had voted for Karimov. In those circumstances the election winner was predictable and Karimov received 93.9 per cent of all votes (Akimov & Dollery 2009b).

As a result of internal and external shocks in 1996-1998, economic policies in Uzbekistan have dramatically changed. In response to poor cotton and grain harvests; a drop in price for major exports; and the Russian crisis, Uzbek government softened monetary policy and introduced foreign currency rationing. The authorities announced a switch to an import substitution policy by directing large credits import substitution projects. Moreover, some of those projects received additional subsidies through low exchange rates (Akimov & Dollery 2009a).

Exchange rate rationing improved current account and trade balances on one hand but encouraged 'rent-seeking' activities by bureaucrats. Overvalued local currency damaged the competitiveness of local exporters and created disbalances in the economy. Privatisation program has also stalled, apart from basic consumer services (Ruziev, Ghosh & Dow 2007).

The reform reversals did not slow down Uzbek economy, which registered a positive rate of growth recorded in 1997-1999. Inflation has gradually reduced to the level of 50 per cent in 1998-1999. Moreover, budget deficit was kept under control despite continuous funding of social programs (Akimov & Dollery 2009a).

In financial sector, the government introduced a number of important reforms, such as new payment system, better accounting standards, new regulatory framework in line with BIS requirements, launch of the stock exchange and treasury instrument trading. On the other hand, the government consolidated banking system in its hands (with over 70% of banking assets held by state-owned banks) and kept control over lending and deposit rates offered by the banks (Akimov & Dollery 2006).

² Karimov left the PDPU in 1996

2.5 Established political regime and 'ad hoc' economic developments, 2000-2007

In 2002, the government initiated further constitutional reform by extending the presidential term in office from five to seven years, and creating a bi-cameral parliament. Both initiatives were approved through referendum with a 91 per cent and 93 per cent of votes respectively.

In 2004, the new bi-cameral parliament was elected. It consisted of a senate (100 seats) and a legislative chamber (120 seats). Senators were elected by regional councils (84 seats) and appointed directly by the President (16 seats). Since the regional governors were appointed by the President, the Senate was in fact under presidential control. In the 2004 elections, five pro-government parties had their candidates elected with majority of 41 seats won by the newly-created Liberal-Democratic Party (LDP) headed by the Prime-Minister. Four opposition parties, including *Birlik*, *Erk* and a newly established *Ozod Dechkonlar* (Free Farmers) and the Agrarian Party failed to obtain registration in order to participate in the elections.

Since then, little has changed in the political landscape of Uzbekistan. Parliamentary elections in 2009 followed very similar scenario as previous 2004 elections. The same pro-government parties participated in the elections with the LDP winning the elections with just over a third of all seats. However, it mattered little for the formation of the government. Cabinet, including Prime Minister is appointed by the President. The current Prime Minister – Shavkat Mirzoyoyev represent neither a winning nor first-runner up party and remains at his post since 2003. Leaders of political parties or even parties themselves are largely unknown to the general public.

Uzbek Parliament in 1999 announced a set of liberalisation measures including the reduction of state intervention, the strengthening of legal protection for enterprises from such intervention, and liberalisation of the foreign exchange market. However, these stated reforms remained largely unfulfilled.

The government slowly reduced the huge gap in different foreign exchange rates by devaluing controlled exchange rates. However, reforms in other sectors did not proceed well. Privatisation of large enterprises did not advance due to government's reluctance to give up its majority stake. Agriculture remained largely unreformed. The collective farms, *shirkats* remained largely ineffective due to very weak incentives for individual members. Private farmers, *dehkan* farms, *de facto* had to grow the crops they were told to and sell the harvests to prescribed buyers at a fixed price. Trade regime remained restrictive with some tariffs actually rising to support import substitutions policies, and keep current account balance in surplus (Pomfret 2006).

Prices for utilities, including electricity and urban water, were gradually liberalised since 2001 to the cost recovery level. Payment collection was enhanced by compulsory deduction of all utility payments from resident worker's salary payments.

Multiple exchange rates were unified and convertibility for current account transactions was declared at the end of 2003. However, it did not last long as system of multiple exchange rates gradually returned. Fiscal and monetary policy remained tight, resulting in reduction in public debt and levels of inflation. However, some observers (see, for example, Asian Development Bank 2006) noted deterioration of quality of statistics pointing at increasing divergence between official and alternative estimates of consumer price inflation.

Reforms in financial sector have large stalled. The trust of population in banking sector remained low due to difficulties in accessing cash from customer's bank accounts as well as tax collection responsibilities banks had to fulfil. Moreover, announced privatisations in banking sector did not go ahead and state-owned banks continued their domination in the sector (Ruziev & Ghosh 2009).

Economic growth gradually picked up by 2004 and 2005 thanks to strong agricultural harvests, as well as a robust external sector performance driven by exports of state-owned enterprises. However, share of foreign direct investments remained very low due to the unfavourable business environment. Growing number of migrants started to flow from Uzbekistan to Russia and Kazakhstan for seasonal work and transfer their incomes to supports their family's consumption in Uzbekistan (Kakhkharov & Akimov 2014).

The main economic indicators over 1997-2012 are presented in Table 2.

Table 2. Main economic indicators in Uzbekistan from 1997 to 2007

Indicator	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
GDP growth, %	5.2	4.3	4.3	3.8	4.2	4	4.2	7.7	7	7.3	9.5
GDP per capita ¹	411	422	436	446	459	471	486	517	547	580	626
GDP per capita ²	1506	1545	1594	1632	1679	1725	1777	1892	2001	2121	2290
Domestic savings/GDP	25.3	27.7	24.9	26.0	27.2	22.0	26.3	29.0	29.1	24.8	17.2
Investments/GDP	28.2	28.1	25.1	22.1	26.5	20.8	19.1	20.7	17.9	18	20.9
FDI/GDP (%)	1.1	0.9	0.7	0.5	0.7	0.7	0.8	1.5	1.3	1.0	3.2
Inflation (GDP deflator, %)	66.1	39.0	44.1	47.3	45.2	45.4	26.7	15.7	21.4	21.5	24.0
Budget deficit (% of GDP)	-2.4	-3.0	-2.6	-2.2	-1.3	-1.9	0.1	1.2	2.8	6.8	5.4

¹ Constant, year 2005 USD

² PPP method; in USD

Source: European Bank for Reconstruction and Development (2002, 2005, 2007, 2010); World Bank (2014a).

2.6 Politics and economy post-GFC, 2008-2013

The most recent presidential elections were conducted at the end of 2007. According to Central Election Committee of Uzbekistan (2007), Karimov received 88.1 per cent of all votes, whereas other three carefully pre-selected candidates around three per

cent each. Since Uzbekistan Constitution only allows a president to stay two terms in the office it is unclear on what grounds Karimov was allowed to run. No explanation was offered to the public by election officials or the country leadership for that. The presidential term has been reduced back to five year through the amendments into Constitution in 2011. Next elections are due in early 2015 and it is very unlikely that Karimov will voluntarily step down. Instead he will likely to run and be elected for another (five-year) term. He will likely to continue to get re-elected that until either natural forces will take place (Karimov will turn 82 in 2020) or he will be overthrown by coup from his own circle. Second scenario looks unlikely at this stage as Karimov retains a tight grip over the power in Uzbekistan.

The Uzbek economy has weathered the storm from GFC very well. The GDP has continued to grow at a very healthy level of over 8% (see, Table 3). Due to tight fiscal policy, the budget remained in surplus through the period. Due to active government involvement, investment rates remained steady, savings rebound from the large slip in 2008-2009. Allington and McCombie (2011) identified three possible channels of impact from GFC on Central Asian countries – trade, remittances and capital flow. Due to restrictive government trade policy and low level of integration of Uzbek financial system into the global system, negative effects from trade and capital markets were very small on Uzbek economy. The remittance effect was much stronger as remittances account for around 10% of Uzbekistan GDP. Most of them come from Russia and Kazakhstan (Ruziev & Majidov 2013). Despite the decline in remittances from Russia from \$3007 million in 2008 to \$2071 in 2009, the latter number was still larger than 2007 level. Moreover, remittances rebounded strongly from 2010 with around 40% annual growth (Kakhkharov & Akimov 2014). Relatively small exposure to the drivers of negative impact coupled with strong measures from Uzbek government to counteract negative effects from GFC, including fiscal stimulus, tight monetary policy, banks recapitalisation and administrative price controls for staple products, allowed Uzbekistan to continue strong growth. The cost of the measures will be felt in the longer term as more distortions were introduced to the economy (European Bank for Reconstruction and Development 2009).

Table 3. Main economic indicators in Uzbekistan from 2008-2012

Indicator	2008	2009	2010	2011	2012	change 1990-2012
GDP growth, %	9	8.1	8.5	8.3	8.2	124.4%
GDP per capita ¹	671	713	752	793	846	54.6%
GDP per capita ²	2456	2611	2754	2903	3095	54.6%
Domestic savings/GDP	13.5	8.2	27.7	24.9	20.9	
Investments/GDP	25.3	26.1	24.5	23.1	22.8	
FDI/GDP (%)	2.5	2.6	4.1	3.2	2.1	
Inflation (GDP deflator, %)	19.9	20.8	19.6	15.1	14.8	
Budget deficit (% of	10.7	2.8	4.9	9.0	3.0	

GDP)

¹ Constant, year 2005 USD

² PPP method; in USD

Source: European Bank for Reconstruction and Development (2010, 2012); World Bank (2014a).

3. Political and economic environment in Kazakhstan from pre-independence to after GFC

3.1 Introduction

Kazakhstan is the second largest post-Soviet country in terms of territory, located largely in Central Asia, but also partly in Europe. The total area is 2,717,300 sq. km. The population of the country is multi-ethnic with a majority of Kazakhs (53.4 per cent). Other large ethnic groups include Russians (30%), Ukrainians (3.7 per cent), Uzbeks (2.5 per cent) and Germans (2.4 per cent). Though not always vigorously practiced, the majority of population associate themselves with either of two religions – Islam (47 per cent) and Russian Orthodox Christianity (44 per cent). The Kazakhstan's political structure is a Republic. The Head of State, a President, has considerable authority (Central Intelligence Agency 2014a).

Kazakhstan is country rich in mineral resources, including substantial fossil fuel reserves and plentiful supplies of other minerals and metals. Kazakhstan has extensively exploited its high resource endowment and achieved significant economic growth in 2000s. It is now the most prosperous country in post-Soviet Central Asia and an attractive destination for labour migrants from neighbouring countries.

3.2 Period before Independence

The latter part of the 1980s in Kazakhstan (then a part of the Soviet Union) can be characterised as a period of growing nationalistic self-consciousness among ethnic Kazakhs. Accordingly, when the Soviet leadership replaced the long serving leader of the Kazakh Soviet Socialist Republic (KSSR) and ethnic Kazakh (Dinmukhamed Kunaev) by an ethnic Russian (Gennadi Kolbin), several thousand people protested in Alma-ata (now Almaty) and later in a regional town of Novi Uzen. Shortly after, in May 1989, an ethnic Kazakh (Nursultan Nazarbaev) was appointed as a new leader. With a good command of the Kazakh language and knowledge of Kazakh traditions as well as a good employment record in the Russian-dominated industrial sector, he was able to calm down nationalistic tensions in both the Russian-dominated north and the Kazakh-dominated south.

In the meantime, Nazarbaev was gradually building his grip over power by becoming chairman of Supreme Soviet in September 1989. Newly elected parliament in 1990 has appointed Nazarbaev as a President of KSSR. Nazarbaev continued building his power by securing the support from influential personas, such as Kunaev and by

dispersing political opposition. Nazarbaev retained leadership of the country in presidential election on 1 December 1990 where he was the only candidate and received 98.7 per cent of the vote (Official Website of the President of the Republic of Kazakhstan 2014). The only other possible contender – one of the protest leaders in Novi Uzen riots, Khasen Kozha Akhmet was unable to participate in the election, since the records of signatures in support of his candidature required to run in the elections were stolen (Cummings 2005).

Nazarbaev enjoyed a good relationship with Gorbachev and supported him in his efforts to maintain the Soviet Union as a united country. However, after three leaders of the Slavic republics of Russia, Ukraine and Belarus struck a deal to establish the Commonwealth of Independent States and thereby dissolve the Soviet Union, Kazakhstan also proclaimed its independence on 16 December 1991 (Olcott, M. 1997).

Kazakhstan generally shared in the stagnation of the Soviet economy since the late 1970s. In common with all Soviet republics at the end of the 1980s, Kazakhstan experienced a slowdown in growth, which turned negative in the early 1990s. Since that time, the inflation has accelerated. Agriculture, industry (mining and energy), construction, transport and communication dominated the structure of the output in pre-reform Kazakhstan, accounting for 42 per cent, 21 per cent, 16 per cent and 10 per cent respectively in 1990 (Pomfret 1995).

3.3 Early years of reforms, 1992-1994

Like leadership in every other country of post-Soviet Union, Nazarbaev announced the reforms towards political and economic liberalisation (Gleason 2003). Early years of independence can be characterised by relative freedom of expressions in the political arena. Although Nazarbaev enjoyed wide-spread support of the population and was gradually building a case for establishment of strong presidential republic, it did not happen until 1995. Deputies of Supreme Soviet have actively participated in drafting first Kazakhstan's Constitution with some opposition against Presidential Republic. However, first Kazakhstan's Constitution was passed in January 1993 almost unanimously and significantly strengthened executive branch of power. Some of the most controversial issues such as ability of the President to dissolve the parliament at his/her will were not included in the document. Moreover, constitutional court secured some level of independence (Jones Luong, Pauline 2002a). Regional leaders were able to expand their powers to be able to control a level of political activities in their respective regions.

One of the unique problems Kazakhstan's leadership had to deal with is the ethnical issue. Having large Russian minority in the north of the country, and dominance of Kazakh majority in southern region, it was important to maintain the unity of the country. Nazarbaev allowed political participation of ethnical minorities in regional and national governments. The most notable appointment was Sergei Tereschenko

(ethnic Ukrainian) to the post of Prime Minister. Many of the *akims* (governors) of northern regions were ethnic Russians. Simultaneously, Nazarbaev controlled level of nationalist activity coming from ethnical Kazakhs.

Despite securing much stronger powers under first Kazakhstan's Constitution, Nazarbaev has not achieved as much presidential powers as he was proposing, and therefore could not be completely satisfied. Presidential office has tried securing more powers from the Parliament with limited success due to opposition from the deputies, including parliamentary speaker – Serik Abdildin. Under the pressure from presidential office and controlled media, the Parliament has decided to dissolve itself at the end of 1993, simultaneously granting the President the powers to executive issue Acts before new Parliament is elected. In March 1994 new parliament has been elected albeit with numerous registered challenges to the fairness of the process. Those irregularities were initially ignored (Furman 2005).

Kazakhstan began its own reform program towards a market-oriented economy since independence in 1991. In January 1992, most prices were liberalised. The newly founded Kazakh State Property Committee started work on a programme of privatisation (Pomfret 1995). However, reforms remained largely segmented until 1993, which a Kazakh government official termed a 'preparatory phase' (Jandosov 1998). More intensive reforms began in 1993 with the introduction of a national currency - the 'tenge'. The National Privatisation Programme for 1993-1995 launched the mass privatisation of medium-sized enterprises. That same year, the first large enterprise was privatised by means of successful tender and this process continued on a 'case-by-case' basis. At the end of 1994, new legislation on foreign direct investments was introduced permitting the repatriation of profits. Substantial trade liberalisation was achieved by the first half of 1995, following the abolition of all export quotas and the elimination of most export and import licences (European Bank for Reconstruction and Development 1995).

In financial sphere, policy-makers had to deal with the problem of rapid growth of poorly capitalised and managed banks, and resultant problem of non-performing loans (International Monetary Fund 2000). The number of banks has tripled in 1991-1993. A number of key legislative documents as well as program of dealing with non-performing loans, and prudential regulation and supervision were adopted (European Bank for Reconstruction and Development 1995).

3.4 Political consolidation and economic reform acceleration, 1995-1997

New parliament, despite Nazarbaev's expectations, has not become more obedient and was resisting adoption of a new Constitution. Moreover, former Communist Party has re-incarnated itself initially in Social Party of Kazakhstan and secured fourteen seats in the new parliament. Moreover, newly created National Congress of Kazakhstan got thirteen seats in the parliament with its leader Olzhas Suleimenov

declaring his intentions to run for presidency in 1996 and challenge Nazarbaev (Cummings 2005). Both problems were solved when Constitutional Court upheld one of the complaints against election results in March 1995 (one year after the election) and ruled that whole elections were invalid. The parliament was dissolved. Nazarbaev stepped in to call the referendum to extend his term in office until 2000 and won over 95% votes. Shortly after, the new Constitution, which granted Nazarbaev much greater presidential powers, was approved in referendum with around 90% votes. In December 1995, new much smaller size bi-cameral parliament was elected (Gleason 2003). These set of events completed domination of executive power branch over legislative and judicial. There were no more threats to the president's power coming from the parliament. Instead challenges to the president came from executive branch and the president's inner circle.

Prime Minister in 1994-1997, Akezhan Kazhegeldin, who generated considerable wealth in early independent years, got a reputation of a strong reformer. He did not display sufficient loyalty to the president, instead exercised considerable independence in his economic policies. Moreover, he got into confrontation with Nazarbaev's daughter – Dariga and his son-in-law Rahat Aliev. Nazarbaev has dismissed Kazhegeldin on the grounds of obsession with reforms and not addressing social issues (Furman 2005). After dismissal, Kazhegeldin initially did not voice any criticism towards president. Soon after, he openly challenged president's stance of unsuitability of western democracy in Kazakhstan and expressed his intention to run for presidency in 2000 using liberalisation and democratisation platform. This would not eventuate as Nazarbaev called for early election in 1999, and ensured Kazhegeldin could not run due to administrative violation charges against him. With no real competition, Nazarbaev easily won the elections with nearly 80% votes. The same year, new parliament was elected with the domination of freshly created pro-presidential pocket parties such as *Otan*, Civil party and Agrarian party (Furman 2005; Gleason 2003). In 2000, Constitutional Act on First President of Kazakhstan was adopted, which removed limit on how many terms in office the first president can serve. Moreover, the Act guaranteed Nazarbaev's impunity and protection from any sort of prosecution.

Kazakhstan undertook an extensive privatisation and liberalisation program in 1993-1996. In 1993, the citizens were distributed vouchers that they could investment in purchasing state-owned asset through Privatisation Investment Funds (PIFs). Once privatisation of small and medium size enterprises was largely complete, case by case privatisation of major state owned companies has started. Kazhegeldin government has extensively employed foreign experts to manage state-owned enterprises using management contracts. The liberalisation of prices was complete in 1994. The government established liberal trade regime with all export quotas and many export and important licensing requirements lifted. Tariffs were drastically reduced towards 1997. Large number of foreign direct investments started to flow into the country, predominately into oil and gas sector.

Local currency - tenge became freely convertible in 1996, and Kazakhstani government floated its first Eurobond. Directed credits in banking sector were abolished in 1995 and limits placed on borrowing by the government from National Bank of Kazakhstan (NBK). In banking sector, NBK started to gradually allow foreign bank entry, and worked on improvement of prudential regulation and supervision practices. Accounting standards were gradually improved with introduction of new charts of accounts in 1995 (Akimov, Alexandr & Dollery, Brian 2008).

NBK continued to deal with a bulk of non-performing loans through closing small non-viable banks, and creating asset management companies to deal with the bad loans of the larger banks. Around loans equalling 11 per cent of GDP were transferred from original banks to specialised institutions (Hoelscher 1998).

Kazakhstan's GDP has experienced larger and longer decline than in Uzbekistan. Unlike Uzbekistan, Kazakhstan had to deal with a problem of declining in population due to large migration outflows. Both investment and savings rate were declining. However, they were partly offset by rapid growth in FDIs. Due to smaller social program, Kazakhstan maintained better budget position. Moreover, it got inflation under control much earlier. Table 4 summarises Kazakhstan's economic performance in 1991-1997.

Table 4. Kazakhstan's economic performance in 1991-1997

Indicator	1991	1992	1993	1994	1995	1996	1997
GDP growth, %	-11.0	-5.3	-9.3	-12.6	-8.2	0.5	1.7
GDP per capita ¹	2718	2576	2355	2088	1951	1990	2056
GDP per capita ²	6270	5942	5431	4816	4499	4591	4743
Domestic savings/GDP	na	30.2	11.2	18.7	18.7	15.4	13.1
Investments/GDP	na	30.4	27.9	26.1	23.1	17.2	16.3
FDI/GDP (%)	na	0.4	5.4	3.1	4.7	5.4	6.0
Inflation (GDP deflator, %)	96	1472	1243	1547	161	39	16
Budget deficit (% of GDP)	-7.9	-7.3	-4.1	-7.5	-2.7	-4.7	-6.8

¹ Constant, year 2005 USD

² PPP method; in USD

Source: EBRD (1995, 2003); World Bank (2014a)

3.5 Challenges to political stability and economic revival, 1998-2007

Second challenge to the president's rule came from much closer source- president's inner circle. President's son-in-law, who played an important role of dismissing Kazhegeldin's challenge, gradually generated considerable wealth and influence in Kazakhstan's politics. As a result of his aggressive tactics of taking control over various sectors of the economy, Aliev opponents united against him, including some members of the president's inner circle. Initially reaction was to move Aliev from his previous job as a deputy chairman of Committee of State Security closer under

Nazarbaev's control as a deputy head of Nazarbaev body guard. Aliev continued make threats of exposing corruption in president's circle and therefore had to be removed further away. He was sent as an Ambassador to Austria, where Aliev later asked for 'political protection'. Dariga Nazarbaeva divorced Aliev, and the latter's political career in Kazakhstan was officially over. However, he continued his efforts to damage reputation of Nazarbaev and members of his inner circle in series of interviews and publications.

In dismissing Aliev, significant role was played by a group of young business elite as well as ministers and parliamentarians united under the brand of Democratic Choice of Kazakhstan (DCK). Most prominent were former governor of Pavlodar – G. Zhakiyanov and Temirbank head – M. Ablyazov. They got into open confrontation against prime minister at the time- K. Tokaev, with number of bureaucrats losing their job in this power struggle. As happened earlier though, this rising threat of opposition was crushed by Nazarbaev through arrests of the DCK leaders. Other executive members in DCK such as U. Zhandosov and K. Kelimbetov got important government posts and registered new party *Ak-Zhol* with a more moderate opposition stance.

In 2003, arrest of a presidential advisor – J. Giffen in US as part of corruption investigation of alleged bribery payments by US companies to Nazarbaev and Prime Minister – Balgimbaev in return to oil development contracts significantly undermined Nazarbaev's reputation both domestically and especially abroad. The scope of the problems led some commentators (such as, Gleason 2003) to predict Nazarbaev's imminent resignation in some complex succession plan. This was not to eventuate as Nazarbaev proved yet again his ability to manage political problems.

The 2004 parliament elections were again dominated by pro-presidential *Otan* party with over 60% of the votes. The elections failed to meet democratic standards yet again. Some of Nazarbaev's allies left the party and ministerial posts in protest of the election irregularities including –Deputy Head of *Otan* Party - Zh. Tuyakbai and minister for information - A. Sarsenbaev and joined the opposition (Olcott, Martha 2010).

Presidential elections took place soon after that, in 2005 with Nazarbaev receiving over 91% of votes. Main opposition came from Zh. Tuyakbai, and leader of For Just Kazakhstan Coalition (containing Communist Party, *Ak-Zhol* and Democratic Choice of Kazakhstan) receiving little over 6%. A number of high profile killings of prominent politicians and critics of Nazarbaev regime further damaged Nazarbaev's reputation.

In 2006, Dariga Nazarbaeva's *Asar* party, as well as Agrarian and Civic parties merged with *Otan* party under the new brand of *Nur-Otan*. A range of Constitutional changes took place in 2007. This included increasing of the size of the parliament, replacement of direct election of the deputies to the one based on the popular vote for

party lists. New parliamentary elections took place in 2007 with none of the opposition parties able to reach required barrier of 7 per cent. All the deputies in the new parliament belonged to president's *Nur-Otan* party.

After the widespread reforms in mid-1990s, where the basis for future growth has been laid, Kazakhstan enjoyed the period of economic revival. Although it did not start until year 2000 due to effects of Asian and Russian crises in 1997-1998 where the government re-installed some temporary trade protection and foreign exchange rationing measures. The growth rate of around 10% were largely driven by hydrocarbon sector enjoying rapid growth in production, high market prices, and continuing foreign investments. Moreover, financial sector has been developing rapidly too with gradual reduction of the state's share in banking sector, pension reform towards accumulation system, which kicked off in 1998 and assisted activity of local stock exchange. Improved access to credit by business and consumers contributed to a rapid growth in construction sector, retailing and services. Re-discovered confidence in banking sector helped to improve savings and investment rates. Foreign direct investment remained at very high levels throughout the period. Budget deficit turned surplus from 2001 and remained positive and strong till GFC.

The privatisation of blue chip companies has slowed down due to diminished need in privatisation revenues. The challenges remained in restructuring old public infrastructure and building new. Rapid growth in capital inflows led to higher inflation rates and appreciation of real rate of local currency. In banking sector, easy access to cheap foreign currency credit, started to create challenges to local regulator as a reliance on short-term and long-term foreign currency finance grew rapidly.

Overall, this is the period where Kazakhstan received lots of praise from international commentators for its success in economic reforms and growth. The intentions were raised by Kazakhstan's political leadership to join the ranks of the so called BRICS (Brazil, Russia, India, China and South Africa) with large and fast growing economies (Olcott, Martha 2010).

The major economic indicators are summarised in Table 5.

Table 5. Kazakhstan's economic performance in 1998-2007

Indicator	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
GDP growth, %	-1.9	2.7	9.8	13.5	9.8	9.3	9.6	9.7	10.7	8.9
GDP per capita ¹	2052	2127	2344	2664	2925	3187	3469	3771	4131	4447
GDP per capita ²	4734	4909	5406	6146	6748	7351	8001	8699	9529	10259
Domestic savings/GDP	15.9	16.0	25.6	25.8	27.2	31.1	34.9	39.8	44.6	42.2
Investments/GDP	15.7	16.2	17.3	23.7	24.0	23.0	25.1	28.0	30.2	30.0
FDI/GDP (%)	5.2	9.4	7.0	12.8	10.5	6.8	9.6	4.5	9.4	11.4
Inflation (GDP deflator, %)	5.7	13.3	17.4	10.2	5.8	11.7	16.1	17.9	21.6	15.5
Budget deficit (% of GDP)	-8.0	-5.2	-1.0	1.8	1.0	3.0	2.5	5.8	7.2	4.7

¹ Constant, year 2005 USD

² PPP method; in USD

Source: European Bank for Reconstruction and Development (2002, 2005, 2007, 2010); World Bank (2014a).

3.6 Political and economic developments post-GFC

In the lead-up to Kazakhstan's Presidency in OSCE, Kazakhstan has undertaken some reforms in electoral law, which guaranteed runner-up party to gain some parliamentary seats even if it is to fail to reach 7% barrier.

Latest presidential elections in 2011 and parliamentary elections in 2012 did not provide any challenge to the president. Nazarbaev received over 95% of votes against only three little known contesters who were allowed to run for presidency. In 2012, *Nur-Otan's* domination continued with over 80% of votes. However, this time, two other parties – Communist party and *Ak-Zhol* gain some seats in the parliament.

The notable political event in Kazakhstan's recent political landscape was 2011 Zhana-Ozen protests. Oil field workers whose protest for better job and pay conditions remained ignored by state-run oil companies, started to voice dissatisfaction by level of liberties in Kazakhstan. The protest has been crushed by police with at least sixteen killed and scores injured. President has responded by sacking a number of regional and government officials, including his son-in-law T. Kulibaev, head of government fund *Samryk Kazyna*, who controlled strategic government oil assets. Protest organisers were put on trial.

In April 2014, Dariga Nazarbaeva was appointed a deputy speaker of the lower house of the parliament and head of *Nur Otan* parliamentary group. This is likely to bring new speculations about Nazarbaev's succession plan. Even if these speculations have some credibility, it is highly unlikely for Nazarbaev to step down any time soon. In mid-2000, he voiced his intentions to stay until at least 2020 (when he will turn 80). His health permitting, Nazarbaev will run for the election in 2016 and will likely win with the decisive majority as has happened in the past.

Due to much higher integration of Kazakh economy into global economy, Kazakhstan has felt the impact of the GFC much stronger than Uzbekistan. Firstly, as a major exporter of energy resources into the global market, it faced sharp decline in demand for energy resources and prices at the end of 2008. As a result, Kazakhstan's GDP declines 1.9% in 2008. However, with the healthy macroeconomic position and reserves, it did not shake investors' confidence who continued to participate in the energy projects. Therefore, FDI remained at the very strong level. With the rebound of global energy prices, the GDP growth turned positive in 2009, and GDP growth rates returned to pre-crisis level in 2010. Direct fiscal stimulus through tax decreases and spending on social programs has resulted in temporary budget deficit in 2009. Main post-GFC economic indicators are summarised in Table 6.

Table 6. Kazakhstan's economic performance in 2008-2012

Indicator	2008	2009	2010	2011	2012	change 1990-2012
GDP growth, %	-1.9	2.7	9.8	13.5	9.8	74.5%
GDP per capita ¹	4538	4473	4732	5015	5191	68.9%
GDP per capita ²	10469	10318	10916	11568	11973	68.9%
Domestic savings/GDP	47.6	37.6	40.1	43.9	40.5	
Investments/GDP	26.8	27.8	24.3	20.7	20.8	
FDI/GDP (%)	12.6	12.4	5.0	7.6	7.4	
Inflation (GDP deflator, %)	20.9	4.7	19.5	17.6	4.8	
Budget deficit (% of GDP)	1.2	-1.2	1.5	5.9	3.6	

¹ Constant, year 2005 USD

² PPP method; in USD

Source: European Bank for Reconstruction and Development (2010, 2012); World Bank (2014a).

Second channel of crisis transmission was the banking sector. With rapid growth of foreign borrowing to finance hungry construction sector pre-GFC, Kazakhstan's banking system became increasingly vulnerable to any external shock. Lending practices in banks have weakened, corporate governance remained poor and bank regulation and supervision did not keep up with the rapid developments. Although, there was no direct exposure to subprime US mortgages by Kazakh banks, their dependence of foreign finance cost them dearly when flow of cheap and untapped credit suddenly dried out during the credit crunch. In turn, Kazakh banks stop extending new credit on the local market, which caused new property development to freeze and property prices to plummet. As a result, Kazakh banks have discovered that many of their borrowers were unable to service their loan with non-performing loan ratios growing rapidly. Two banks were particularly hardly hit, Bank Turan Alem (BTA) and Alliance bank, the largest and fourth largest banks respectively (Barisitz & Lahnsteiner 2010).

In response, NBK has acquired 75% stake in BTA, as well as 28% and 18% stakes in the second and third largest banks of Kazakhstan (Halyk bank and Kazkommertsbank). Moreover, to prevent bank runs, it has increased deposit guarantee to 5 million tenge (US\$33,500). The government extended a \$3 billion support package to struggling real estate sector, \$1 billion each to small and medium business, agriculture and infrastructure projects (Bissenova 2009).

Despite taking over Turanalem and Alliance bank, the government (through the national fund Samruk Kazyna) refused to guarantee the banks' debt and entered into negotiation for the debt restructuring with an intention to make a partial debt write-off. It settled the deals with bondholders of Alliance bank in 2010 and BTA in two stages in 2010 and 2012 to bring capital adequacy of Kazakh banking system back to the acceptable levels. However, process of cleaning the portfolio of non-performing

loan remains slow and incomplete, with major banks reluctant to transfer their assets to Problem Loan Relief Fund run by NBK. NBK has acquired back the prudential regulation and supervision functions from Financial Supervisory Agency to better coordinate banking sector relief efforts (European Bank for Reconstruction and Development 2012; International Monetary Fund 2013).

Finally, in response to the poor performance of pension funds, Kazakh government decided to consolidate all pension into single state-run pension fund. The effectiveness of this major remains doubtful as state-owned funds have not fared any better during GFC.

4. Political economy of dictatorship framework and case of Uzbekistan and Kazakhstan

4.1 Evaluation of the political reforms

As it is visible from the evaluation in section 2 and 3, the reform effort towards the goals announced early in transition, democratisation and shift to the market economy has been uneven in both countries. Process of democratisation and electoral reforms started by Gorbachev in the late years of USSR and extended to both republics. This relative freedom achieved before the USSR dissolution has continued in very early years after Independence. Country leaders in both countries announced plans for further democratisation. The reality proved to be different. Uzbekistan leadership swiftly stepped up in tightening political freedoms. By 1994 the level of political rights/electoral process in Uzbekistan were classified as “Not Free” by Freedom House (Jones Luong, Pauline 2002b). Referendum in 1995 to extend Karimov’s powers to 2000 was a symbolic proof of the full dominance of presidential powers. Since then, a little has changed in the political landscape in Uzbekistan where the president enjoys complete monopoly of power. Civil liberties have diminished from the level of ‘Partly free’ in 1991-1992 to ‘Not free’ in 1993 and after.

Tightening powers in the hands of president in Kazakhstan was much more gradual with various pockets of resistance and challenges initially coming from the parliament and then from president’s inner circle. It is not surprising taking into account much more versatile political landscape in Kazakhstan where ethnical composition, belonging to a horde (*zhuz*), as well as large geographical size of the country served as an added complexity for the president to consolidate his powers. Nevertheless, Nazarbaev proved his excellent abilities to navigate through these constraints and achieve presidential domination. Kazakhstan has enjoyed and still enjoys much greater civil liberties although they were tightened somewhat in last few years with high profile journalist prosecutions. Most of the official media is now under governmental control, however, unlike Uzbekistan, Kazakhstan does not censor/restrict access of their citizens to the internet. Tables 7a,b present dynamics of political freedoms and civil liberties in Uzbekistan and Kazakhstan from 1991 to 2013.

Table 7a. Dynamics of political freedoms and civil liberties in 1991-2000**Table 7a. Dynamics of political freedoms and civil liberties in 1991-2000**

	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/2000
<i>Political rights</i>									
Kazakhstan	5	5	6	6	6	6	6	6	6
Uzbekistan	6	6	7	7	7	7	7	7	7
<i>Civil liberties</i>									
Kazakhstan	4	5	4	5	5	5	5	5	5
Uzbekistan	5	6	7	7	7	6	6	6	6

Source: Jones Luong (2002:16)

Table 7b. Dynamics of political freedoms and civil liberties in 2001-2013

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<i>Electoral process</i>													
Kazakhstan	6.25	6.25	6.5	6.5	6.5	6.5	6.5	6.75	6.75	6.75	6.75	6.75	6.75
Uzbekistan	6.75	6.75	6.75	6.75	6.75	6.75	6.75	7	7	7	7	7	7
<i>Civil society</i>													
Kazakhstan	5	5.5	5.5	5.5	5.5	5.75	5.75	5.5	5.5	5.75	5.75	6	6.25
Uzbekistan	6.5	6.75	6.5	6.5	6.5	7	7	7	7	7	7	7	7

Source: Freedom House (2012, 2013)

Overall, it is evident that in both countries citizens could not really establish a significant ability to influence political agenda. By mid-1990s, presidents in both countries established a monopoly over the power and voters lost any possible avenue for the change through the election process. In that sense, the announced process of political transition has never really commenced. Quite contrary, by mid-1990s highly autocratic regimes were established in both countries with no interest from ruling elite to return to democratisation.

4.2 Evaluation of economic and financial reforms

In terms of economic reforms, Kazakhstan has been able to advance much further in terms of economic liberalisation and shift towards market economy. It introduced much deeper market reforms in early years of transition, especially in terms of privatisation, price liberalisation and trade and foreign exchange system. In 2000s, Kazakhstan has undertaken more extensive reforms in its financial system, which allowed business and individuals to access much greater scope of financial services. However, both countries failed to undertake a significant reforms in governance, enterprise restructuring and competition policy with Kazakhstan slightly ahead in terms of EBRD transition indicators (see table 8).

Interestingly enough both countries have had very little progress in their reforms since 1998 with some reforms reversals such as once in financial systems in both Uzbekistan and Kazakhstan post-GFC. It appears that leaderships in both countries have largely completed the establishment of economic system they believed is appropriate for their respective countries. All the reforms after that were either

relatively small or were introduced in response to some significant external economic or political events.

More radical reforms in Kazakhstan in early transition years were costlier in terms of loss of output and GDP decline. However, the economy rebound stronger through the use the country's mineral resource endowment for building the prosperity of its citizens. Higher level of economic freedom in Kazakhstan provides incentives to better exercise entrepreneurial ability of Kazakhstan's people. Relative openness and stronger integration of Kazakh economy into global economy made the country more exposed to global economic cycles. Rapid rise and burst of its financial system pre and post-GFC provides glaring example of this.

In contrast, Uzbekistan has progressed either moderately or little in their declared move towards market economy. The authorities continue its strong involvement in economic processes constraining private economic activity. Through the tight management, Uzbekistan was able to go through early years of transition in a better shape. Moreover, it also enjoyed strong growth rate in 2000s thanks to favourable terms for export revenue and remittances from exported labour. The closeness of Uzbek economy has allowed to remain largely insulated from the global economic downturn and GFC. Moreover, it appears to continuously deliver strong growth rates of the economy. However, one may question reliability of government statics due to the opaque nature and lack of the audit from international organisations.

Overall, it is evident that by 2000 leadership in both Uzbekistan and Kazakhstan has largely established political and economic structure that they desired. They do not seem to be keen to undertake any further reforms towards market economy or democratisation. Therefore, the term 'transition economies', as it was originally proposed to describe process of shifting command based communist systems of the Eastern bloc towards democratic governments of Western style with market economy, seems to be no longer relevant to both countries. It is no surprise that some commentators, such as Rumer (2005) quite rightly concluded that period of transition is ended in those countries. Table 8 provides the dynamics of transition indicators in Uzbekistan and Kazakhstan since independence.

Table 8. Transition indicators in Uzbekistan and Kazakhstan

	1990	1993	1998	2003	2008	2013
<i>UZBEKISTAN</i>						
Large scale privatisation	1.0	1.0	2.7	2.7	2.7	2.7
Small scale privatisation	1.0	2.0	3.0	3.0	3.3	3.3
Governance and enterprise restructuring	1.0	1.0	2.0	1.7	1.7	1.7
Price liberalisation	1.0	2.7	2.7	2.7	2.7	2.7
Trade & Forex system	1.0	1.0	1.7	1.7	2.0	1.7
Competition Policy	1.0	2.0	2.0	1.7	1.7	1.7
Banking reforms	1.0	1.0	1.7	1.7	1.7	1.0

Non-bank financial institutions	1.0	1.0	2.0	2.0	2.0	2.0
<i>KAZAKHSTAN</i>						
Large scale privatisation	1.0	2.0	3.0	3.0	3.0	3.0
Small scale privatisation	1.0	2.0	4.0	4.0	4.0	4.0
Governance and enterprise restructuring	1.0	1.0	2.0	2.0	2.0	2.0
Price liberalisation	1.0	2.7	4.0	4.0	4.0	3.7
Trade & Forex system	1.0	2.0	4.0	3.3	3.7	3.7
Competition Policy	1.0	1.0	2.0	2.0	2.0	2.0
Banking reforms	1.0	1.0	2.3	3.0	3.0	2.7
Non-bank financial institutions	1.0	1.0	2.0	2.3	2.7	2.3

Source: EBRD (1998, 2003, 2008, 2013)

4.3 Classification of dictatorships

Taking into account the regimes established in Uzbekistan and Kazakhstan, it is more appropriate to analyse the reforms from the point of view of political economy of dictatorship. There is a vast literature discussing and classifying various forms of authoritarian regimes. Most of them were focusing on political aspects of regimes. The literature that clearly links dictators, their types and economic models of behaviour is somewhat limited. Wintrobe (1998) has offered the most complete classification of regimes to-date using economic arguments. The framework offered by Wintrobe (1998) tries to describe what various types of authoritarian regimes are trying to maximise. Wintrobe identifies four types of authoritarian regimes: totalitarian, tinpot, tyranny and timocracy. The differentiation comes from the level of repression used to maintain the regime and level of loyalty the dictators enjoy from the people (see table 9). Dictator's power is considered to be a function of loyalty and repression. Dictator's surplus comes from the difference of generated taxes and spending on public goods and repressions.

Table 9. Classification of authoritarian regimes

Loyalty \ Repression	High	Low
	High	Totalitarianism
Low	Tyranny	Tinpot

Source: Wintrobe (1998)

Totalitarian regime is assumed to maximise dictator's power subject to a positive dictators surplus. Tyranny is similar to totalitarianism except with much lower levels of loyalty. Tinpot dictatorships are assumed to maximise surplus provided the keep level of power sufficient to stay in the office. Finally, timocracy is example of benevolent dictatorships, which tries to maximise citizen's utility subject to positive surplus and sufficient power to remain in the office.

To be able to understand the functioning and longevity of authoritarian regimes in Uzbekistan and Kazakhstan, it is important to choose an appropriate category in which the regimes fit in. Style of leadership President Karimov has been pursuing is well documented in his earlier publications where he advocates strong leadership role of the state in undertaking reforms in all spheres (Karimov 1993, 1995). His action to establish complete dominance in political sphere, oppress any attempts of mildest forms of opposition, lack of civil liberties and freedom of speech, continued state involvement in economic affairs, extensive law enforcement machine represented by police and security service clearly indicate high level of repression. Therefore, tinpot dictatorship regime and timocracy can be easily ruled out in the case of Uzbekistan. The choice lies somewhere between totalitarianism and tyranny. It is hard to determine level of loyalty, Karimov enjoys both among ruling elite and general population. Moreover, it is hard to determine whether it has been changing over time. This is a common problem for dictatorships, as repressions over democratic institutions and freedom of speech reduce the regime's capacity to estimate the level of loyalty it currently enjoys (Wintrobe 1998). The better economic performance in comparison with other post-Soviet countries, as well as maintenance of majority of social programmes in early years suggest that in 1990s, Karimov has indeed enjoyed public popularity and support. His vision for Uzbekistan, backed by successes in early transition periods, and continued relative effectiveness of Uzbekistan's administrative institutions attracted genuine widespread support both from population and some commentators (for example, Pomfret 2000; Spechler et al. 2004). With the rise of extreme opposition, after 1999 bombings and subsequent invasions of small radical Islamist groups in Uzbekistan, the popular support has changed its form. Many residents would still support Karimov as the alternatives were seen as an instability and Islamic radicalisation of society (Abdullaev 2005). With rising cost of living, levels of corruptions and continues lack of civil liberties, the support for the president appears to be gradually fading. This is evident from pockets of resistance that appeared in mid 2000s, most notably Andijan events. However, even now, in private conversations, many residents recognise that even though they are unhappy with the current state of affairs, they do not believe that change of regime will bring any improvements. That shows citizen's loyalty is more a case of 'lesser evil' and 'status quo bias' rather than true believe in positive contribution and benevolence of the current regime. Based on that, we can conclude that perhaps, Uzbekistan's regime should be classified as totalitarian. There is a danger though that further deterioration of citizen's loyalty may warrant re-classification of the regime to the tyranny. Karimov has satisfied all the requirements to ensure longevity and relative stability of the regime: periodical re-shuffling of the ruling elite, managing inter-elite rivalries to ensure overall balance, substantial incentives created to those who secure his regime, such as police, security services and judicial powers as well as bureaucrats. Those incentives encompass relative job security and better pay packages, as well as access to corruption income. As a trained *apparatchik*, he also recognised importance of national ideology. Therefore, the ideology of national independence was developed to assist in maintaining the regime. Although, penetration of this ideology is somewhat

limited, and its effectiveness is well below levels achieved in former USSR, it still plays its part in maintaining the regime. Finally, similar to Nazarbaev he was able to achieve adequate level of legitimacy to stay in power (Matveeva 2009).

Classifying the authoritarian regime in Kazakhstan is more difficult task. Nazarbaev adopted somewhat different style of power and 'governmentality' (Adams & Rustemova 2009). Instead of positioning himself as a strict 'father', who controls all aspects of life of young children, Nazarbaev chose a 'manager (and controlling shareholder) of large corporation' style of rule. This regime allowed more political and especially economic freedom on the ground. The approach allowed some development of the talented managers to grow within the system, provided they continue to maintain the loyalty to the president. Reform-minded individuals were appointed to high posts at various time periods. This includes Kazhegeldin who led swift privatisation process, Marchenko – an architect of financial liberalisation, many of members of Democratic Choice of Kazakhstan held high government posts. Skilful management of the balance of various interest groups, economic successes of late 1990s and 2000s, higher levels of civil liberties ensured popularity of the president both in 1990s and 2000s. In the economic sense, the Nazarbaev's efforts were not dissimilar to the efforts of dictatorship regimes in Chile, Korea and Taiwan. Nazarbaev regime was able to credibly commit to sustaining the institutions (democratic or else) necessary to support business and human capital. Gilson and Milhaupt (2011) labelled such regimes as 'economically benevolent autocracies'.

However, not dissimilar to Uzbekistan's case, over time, perhaps from the second half of 2000s with repression of democratic opposition and various scandals loyalty driven by personal charisma of Nazarbaev has trended downwards. To compensate for the diminishing loyalty, Nazarbaev's regime has been tightening political freedoms and civil rights. It does appear that Nazarbaev's regime in 1990s might be included in that illusive category of benevolent dictators (timocracy in Wintrobe's classification) with high level of loyalty and moderate levels of repressions (mix of high level of political repression and low level of economic intervention). However, with increased repressions in late 2000s and early 2010s, it is getting much closer to the totalitarian regime.

5. Conclusion

Looking back in 2000s, it becomes much clearer why there was very little reform effort put in place in the economy or even more those in the way state functions in Uzbekistan. Lack of any progress towards liberalisation, democratisation and market economy suggest that period of transition is ended. Similar conclusion can be made about Kazakhstan with its lack of progress to democratisation and much slower speed of economic reforms since 2000s. The regimes which satisfies the leader as well as current ruling elites does not require any significant changes albeit for tactical purposes and/or in response to external shocks.

The totalitarian regime maximises its power maintaining high level of repression and reasonably level of loyalty, but also ensures positive dictator's surplus distributed to the ruling elite. Unlike speculations about the leadership's corruption and extensive wealth accumulation, which are common in other dictatorship regimes, Uzbek president keeps his reputation relatively clean with nothing similar to corruption scandals such as Kazakhgate in Kazakhstan. On the contrary, Karimov had his older daughter reprimanded for the actions leading to reputation damages of Karimov family and nationalised some of her accumulated fortunes (Radio Freedom 2014). This confirms that he values his reputation as 'father' of the nation and his power more than wealth accumulation. However, the failure to establish institutions supporting business and human capital investments deny his efforts to be classified 'economically benevolent' dictator, and ensure the rapid progress similar to the one in Korea and Chile, on which he has liked to model his leadership.

Benevolent (timocracy) regimes should be maximising citizen's utility provided positive level of dictator's surplus and minimum level of power to stay in the office. The level of economic freedoms, population has been enjoying shows that this may well have been Nazarbaev's goal. However, with challenges coming to his regimes from time to time, may have created a sense of insecurity for him. This, in turn, may have led to consolidation of his powers, through increased levels of repression in political sphere as well as reduction in civil liberties. Although economic freedom still remain rather high though keeping overall level of repression significantly lower than in Uzbekistan.

Kazakhstan's performance in years preceding the GFC has been clearly superior to Uzbekistan's, and was sense of pride of Kazakhstan's commentators. Symbolic was Nazarbaev's speech in the EBRD annual meeting held in Tashkent in 2006, where he was able to present much better socio-economic outcomes than Karimov did. Karimov was unhappy as it appeared that he is losing personality rivalry in Central Asia. However, much higher exposure to GFC through much more integrated financial system and trade links, made Kazakhstan more vulnerable to its negative effects with dip in the GDP growth rate and problems in banking and broader financial sector, which are yet to resolve.

Uzbekistan's performance during global financial crisis was proudly portrayed by local media as visionary achievements of the leader who deliberately avoided a significant integration into global capital markets, and limited exposure through trade with its trade restrictions. If anything, global financial crisis re-enforced the belief that further liberalisation is unnecessary and may be harmful both to the economy and stability of the country in general. That leads me to the conclusion that any significant efforts towards liberalisation should not be expected any time soon.

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