ANALYSIS OF INFORMAL OBSTACLES TO CROSS-BORDER ECONOMIC ACTIVITY IN KAZAKHSTAN AND UZBEKISTAN

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Abstract

The barriers to trade in developing countries constitute one of the major obstacles to economic development and growth. This study aims at addressing the issues surrounding the prevalence of informal trade barriers in Kazakhstan and Uzbekistan. While it appears to be logical that the strongest economies of Central Asia should increase trade volume with neighboring countries, in reality the potential for intensifying cross-border trade is barely being realized. This paper attempts to shed light on trade barriers in key industries in both countries, including manufacturing, transport, and agriculture. As can be seen from this study, these industries experience different types of restrictions and varying degrees of state intervention in Kazakhstan and Uzbekistan. The paper places special emphasis on informal barriers and the tools companies use to overcome those barriers. The paper is based on a survey of a total of 108 companies in both countries and the output of a roundtable discussion in Kazakhstan with representatives of companies and other experts in the above-mentioned industries.

Keywords: Kazakhstan, Uzbekistan, trade, formal and informal barriers, cross-border activity

JEL Classification: D8, F1, F2, L1, L2

1. Introduction

The former Soviet republics of Central Asia have experimented with many trade models since independence in 1991, but none appear to have been successful as there is currently little trade integration in the region.

This paper studies the trade policies of companies in Kazakhstan and Uzbekistan as the two main regional economic and political heavyweights in Central Asia. According to the International Monetary Fund (IMF) (2011), annual trade volumes in Kazakhstan and Uzbekistan constituted $131 billion and $25 billion, respectively, in 2010. At the same time, the two countries are among the world's worst performers with regard to cross–border trade: Kazakhstan is ranked 176th and Uzbekistan 183th out of 183 countries (World Bank 2012a).[1] This reflects the extremely low level of cross-border economic activity in both countries, which can partly be explained by the fact that states in the region "introduced significant barriers to economic exchange across their sovereign borders after independence" (Linn 2012, p. 103). According to Blackmon (2005), the low level of regional trade in Central Asia can be explained by the desire of the governments of Central Asian republics to remain in the driver's seat of their respective economies. Pomfret (2010) notes that substantial structural improvements are required to facilitate trade across borders in the region.

A quick comparative analysis of the economies of Kazakhstan and Uzbekistan demonstrates notable differences. Rapid reforms in Kazakhstan during the transition after independence led to a recession, whereas Uzbekistan followed a more gradual reform approach that limited economic contraction. In the early 2000s, the situation changed in favor of Kazakhstan due to the discovery of huge oil deposits (Pomfret 2010). However, today the pace of economic growth is similar in both countries, with Kazakhstan ensuring a more open and transparent economy than Uzbekistan. In a similar fashion, both countries continue to reduce their trade barriers as they seek World Trade Organization (WTO) membership. However, the economies of the two countries still suffer from existing formal and informal barriers to cross-border trade that impede their economic development.[2] Roberts et al. (1999, p. iii) define formal (technical) barriers "as regulations and standards governing the sale of products into national markets that have as their prima facie objective the correction of market inefficiencies stemming from externalities associated with the production, distribution, and consumption of these products." In turn, informal barriers can be defined as unwritten regulations that govern economic relations in society although they are not legally adopted (Vakulchuk et al. 2012). Importantly, while formal barriers are rather visible, and hence in many cases measurable, informal barriers remain elusive and are barely measurable. It should be noted that both informal and formal barriers are so intertwined that at times it is difficult to separate one from the other (Rasanayagam 2002). For example, a firm manager can opt for an informal solution to a formal barrier and vice versa.

1 According to the World Bank Ease of Doing Business rank, Kazakhstan was ranked 50th and Uzbekistan 146th in 2013 (World Bank, 2013).

2 Within the framework of this paper we use the term cross-border trade in a broad sense encapsulating not only cross-border trade, but also the notion of entering neighboring markets. Thus, it is used interchangeably with the term cross-border economic activity.

Various scholars emphasize that formal trade barriers (tariffs) are generally low and preferential trade regulations play a minor role in Central Asia (Pomfret 2010; Mogilevskii 2012). In turn, studies to assess the influence of informal barriers on cross-border economic activity, including trade, have been largely lacking. Their influence on trade is discussed in more detail in Section 2.

Thus, this paper aims at providing new empirical observations to the study of informal barriers to trade in three key industries—agriculture, manufacturing, and transport—in Kazakhstan and Uzbekistan. The idea to explore informal barriers stems from the study of emerging market economies in Central Asia.[3] Company representatives interviewed within that study indicate that existing informal barriers reduce the interest of firms in expanding abroad. Moreover, comparing trade volumes among Central Asian countries, a clear tendency of insignificant cross-border trade can be observed. Trade volumes between Kazakhstan and Uzbekistan, and Kazakhstan and other Central Asian states are much lower than trade between Kazakhstan and Ukraine (Agency for Statistics 2012). In 2011, trade volumes between Kazakhstan and Uzbekistan reached $1,950 million, while Kazakhstan's trade volume with France was $6,102 million and with Ukraine it was $4,4049 million.

There are also other factors involved, often informal ones, that impede trade flows within the region. According to the International Trade Centre (2008), the overall competitiveness levels of enterprises in both countries remains low and there is a lack of strong intermediary institutions to assist companies in entering foreign markets. Therefore, we argue that the existing informal barriers are among the main impeding factors for cross-border trade and other economic activity.

Trying to understand which informal barriers reduce cross-border trade between private firms in Kazakhstan and Uzbekistan, an experts round table was organized and a survey was conducted of 108 private firms in the agriculture, construction, and manufacturing sectors. The choice of agriculture, manufacturing, and transport is based upon the consideration that these three sectors are of big importance to the overall economy in both countries and they provide opportunities for cross-border trade.

Agriculture is a large and important sector in Kazakhstan. Its share in Kazakhstan's gross domestic product (GDP) was 4.5% in 2010 (Development Bank of Kazakhstan 2013). Wheat exports are the main component of the agricultural sector, with Kazakhstan as the largest exporter of wheat in the region (OECD 2011, p. 12). Moreover, Kazakhstan's agricultural potential is enormous; it has the second-highest ratio of arable land per person in the world (World Bank 2000; Fergus 2003, p. 109). Agriculture in Uzbekistan, and the cotton industry in particular, plays also a very important role in the economy (Spechler 2007, Zettelmeyer 1998). Its share in Uzbekistan's GDP was 17.8% in 2010 (World Bank 2012b). However, Kazakh and Uzbek agriculture companies do not actively participate in cross-border trade.

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[3] A total of 375 interviews were conducted in Kazakhstan and Uzbekistan with public officials, experts, representatives of international organizations, local and foreign entrepreneurs, and state-owned companies in 2009–2011 within the framework of the 'Emerging Market Economies in Central Asia: The Role of Institutional Complementarities in Reform Processes' project, which was based in Goettingen, Germany.

Transport and manufacturing are also important industries for the economies of both countries. In Kazakhstan, transport accounted for 8.0% of GDP in 2010 (Development Bank of Kazakhstan 2013) and in Uzbekistan its share was 15.2% in 2011 (BVV 2012). Manufacturing amounted to 12.7% of GDP in Kazakhstan in 2011 (World Bank 2012c) and 8.6% of GDP in Uzbekistan in the same year (Index Mundi 2013). Moreover, for the majority of private companies these industries offer significant potential for internationalization; that is, the capacity to expand their activities abroad. Yet, as argued by experts during the roundtable discussion, private firms in the transport and manufacturing industries in Kazakhstan and Uzbekistan demonstrate little interest in participating in cross-border economic activities, often due to the existence of informal barriers.

Thus, our study is driven by the following research question: what is the influence of informal barriers on cross-border economic activity between private firms in the agriculture, manufacturing, and transport sectors in Kazakhstan and Uzbekistan? Our hypothesis is that the existence of these barriers impedes larger trade volumes between neighboring Central Asian states as it serves as an obstacle for companies seeking to enter foreign markets. In this paper, informal barriers to trade and solutions to them are first categorized and then evaluated. The paper also provides policy recommendations for the governments of the region and international organizations on the elimination of informal barriers to cross-border trade.

2. What does the literature say about informal barriers to trade in Central Asia?

The informal economy plays a major role in developing economies. For example, in India the informal sector accounts for 93% of total employment (NSSO 2005). According to Bohata and Mladek (1999), Hashi (2001), and Bartlett and Bukvic (2001), formal barriers appear to be the most important barriers, especially in transition countries. However, the Central Asian context is rather different in which informal barriers play a negative role in restricting economic activity. We acknowledge that it is difficult to identify and measure the influence of informal barriers. However, in our paper we partly solve this methodological problem and shed light on the existing observable informal barriers by surveying representatives of companies that are both subjects and objects of informal economic relations.

In the framework of this paper, we define "informality" as unwritten laws and regulations that are guided by a set of practices and norms that are known and accepted universally by local social and economic actors. Dunn (2003) refers to informality as a problem-solving tool in the former Soviet Union. He argues that informality was a cornerstone of the entire Soviet system and, as a result, many Commonwealth of Independent States (CIS) countries experience a "path dependence hangover." In Central Asia, the Soviet notion of informality was exacerbated by the persistence of the oriental culture, embedding informality in the minds of Central Asians. For instance, many Uzbeks freely participate in the informal sector (Spechler 2007).

Pomfret (2006) brings this argument further by arguing that the collapse of the Soviet Union sharpened the problem of informal trade barriers since the established links—including the cross-border movement of goods, people, transport, and equipment—between the republics of the Soviet Union were broken once and for all. Taking into account that the collapse of the Soviet Union happened unexpectedly, informal institutions filled the vacuum. Pomfret (1999) and Luong and Weinthal (2002) note that the landlocked status of Central Asian countries only exacerbated the problem. Because of the above-mentioned problems, heavy import tariffs and quantitative restrictions on certain goods (in the case of Uzbekistan), illegal trade by means of smuggling, and under-invoicing flourished (Ruziev and Ghosh 2009, Ibraimov 2009). Under-invoicing is an effective mechanism in which two contracting parties agree to put a smaller transaction amount in the contract order than the actual price of delivered goods or services in order to pay less taxes (Raballand et al. 2005). This mechanism is widespread in Central Asia and it greatly adds to the explanation of trade imbalances within the region and with third parties outside the region (Zhukov and Reznikova 2008). Another problem peculiar to Uzbekistan is the restricted access to cash and the absence of currency conversion (Perlman and Gleason 2007, Khalmurzaev 2000, Akimov and Dollery 2006). The more restrictions on formal trade were imposed, the more the bubble of informal trade magnified (Megoran et al. 2005, p. 721; Verme 2006).

As for international organizations, technical barriers to trade in the region have been studied and analyzed by the World Bank, Asian Development Bank (ADB), and the United Nations Development Programme (UNDP). According to ADB (2007), these barriers are carryovers from the Soviet system. The Business Environment and Enterprise Survey (BEEPS), a joint effort of the World Bank and the European Bank for Reconstruction and Development, highlights the role of existing barriers. The survey is conducted among firm managers and owners of enterprises and seeks to provide a deeper understanding of the business environment and the productivity of firms in each country under review. The list of topics covered includes infrastructure, trade, finance, regulations, taxes and business licensing, corruption, crime and informality, innovation, labor, and perceptions about obstacles to doing business (World Bank 2008). According to BEEPS, the role of the informal sector in Uzbekistan in 2008 constituted only 7%–8% of GDP, with a somewhat larger share of the informal sector as a percentage of GDP in Kazakhstan (World Bank 2000). However, BEEPS focuses on the internal business environment, whereas cross-border barriers are hardly considered.

In contrast to BEEPS, the World Bank Doing Business indicators highlight the ease or difficulty of conducting cross-border trade (World Bank 2012a). However, these indicators focus on formal obstacles to cross-border trade such as the number of documents and days required to export, as well as the costs involved. Figure A1 in the Appendix shows how Kazakhstan and Uzbekistan rank globally with respect to the ease of trading across borders: Kazakhstan is ranked 176th and Uzbekistan 183th out of 183 countries. Given this low level of cross-border trade, it becomes important in the present study to identify all possible obstacles hindering cross-border economic activity in these two countries.

Therefore, while many studies were conducted to assess the impact of formal barriers on cross-border economic activity, only a few scholars have analyzed the impact of informal barriers to cross-border trade in Central Asia. Vakulchuk et al. (2012) argue that the governments of Central Asian should invest more resources into the creation of effective institutions to fill gaps in the knowledge of foreign markets, which currently serves as an important informal barrier to cross-border trade in services. Another study, Effective Governance Perspectives in Central Asia: The Case of the Transport Sector in Kazakhstan and Uzbekistan, addressed the problems of synchronization and harmonization of road construction and maintenance strategies in Kazakhstan and Uzbekistan. The results of the study explicitly illustrate the significance of informal institutions in both countries (Irnazarov et al. 2013).

Thus, it could be concluded that the issue of informal trade barriers in Central Asia has been under-researched. There is no specific focus on the three sectors under investigation, as the literature mainly focuses on a macro perspective. Thus, our study contributes to this field of knowledge by identifying informal barriers in two countries.

3. Methodology

3.1 Sampling and data collection

The main research method for data collection in this paper was a firm-level survey. It had to be utilized to identify informal barriers and their role in cross-border trade.

The main issue we addressed in the survey was the impact of informal barriers on trade as well as the way cross-border trade has been developing and functioning under ambiguous trade policies in Kazakhstan and Uzbekistan since independence from the Soviet Union. The main tool we used was a questionnaire that provided a framework within which questions were structured and developed. It was built upon findings from a literature review and consultations with experts in both countries.

Overall, 54 companies in Kazakhstan and 54 in Uzbekistan were surveyed, including state-owned companies and private domestic and foreign firms in the agriculture, manufacturing, and transport industries. The same questionnaire—designed to help identify existing informal barriers to trade—was used in two countries.

As described in Section 1, the three target industries are important for the economies of two countries in terms of their contribution to GDP. Companies representing these industries were randomly selected for our sample using special criteria and a three-stage process (Table 1). First, we composed a list of all companies in the three sectors in both countries (Level 1). Second, we identified those companies which by definition should seek to enter foreign markets and grouped them separately (Level 2). Finally, we randomly selected and approached representatives of 20% of the total number of companies in Level 2 with interest in exporting their products and services abroad (Level 3). This procedure helped us to reduce the bias in the composition of our sample.

Table 1: Sampling Levels

Level 1	Level 2	Level 3
All companies in three industries are identified.	Companies interested in internationalization are identified and grouped separately.	Of the companies identified in Level 2, 20% are randomly selected.

Source: Authors' compilation.

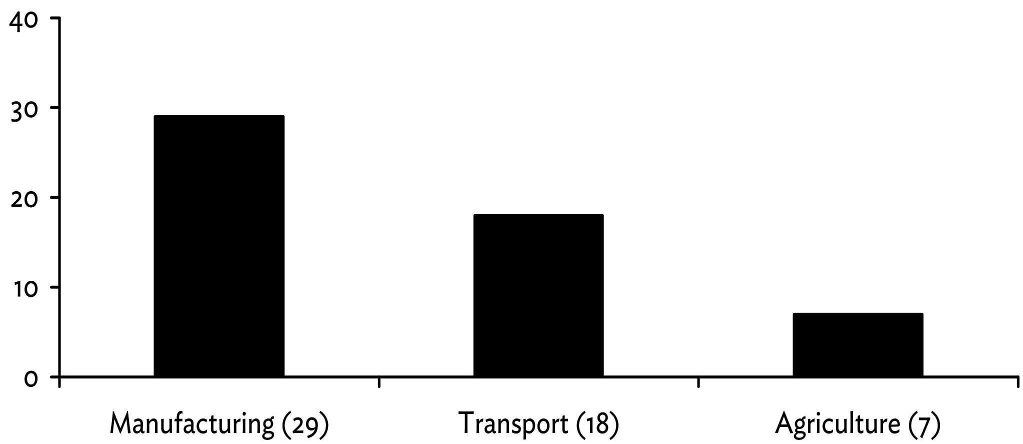
A total of 108 companies were selected. Yet, we did not seek to achieve a high level of representation in our sample in quantitative terms. Rather, we sought to compose a sample across the three industries that would provide us with robust results on the type of informal barriers and their influence on companies' decisions to enter foreign markets. Regarding the size of the surveyed companies, we evenly covered small, medium-sized, and large companies in both countries so that the proportion of each company type by size accounted for 33% of the entire sample.

We acknowledge the limitation that our study does not cover every industry in the economy of both countries. Moreover, a survey of 20% of the companies in the three target industries that are interested in entering foreign markets represents a small portion of the entire population under investigation. However, due to budget limitations it was not possible to survey all export-oriented companies in the three industries. Nevertheless, our sample is representative of the three selected industries and the obtained results shed light on existing informal barriers and the tools companies use to overcome them. Moreover, the results of our study can serve as a starting point for further research of informal barriers to cross-border trade in other industries and countries in Central Asia.

3.2 Descriptive statistics

In Kazakhstan, 40 companies were surveyed in Almaty and 14 in Astana (Figure 1); in Uzbekistan, 40 companies in Tashkent were surveyed and 14 in other regions of the country in 2012. The choice of Almaty and Tashkent for conducting the majority of the surveys is explained by the fact that both cities are the economic centers of their respective country.

Figure 1: Survey Distribution by Industry in Kazakhstan

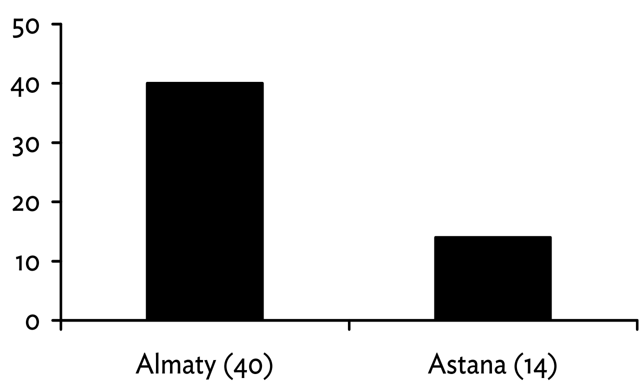


Source: Authors' compilation.

In Kazakhstan's transport sector, 20 private domestic and nine foreign companies were surveyed. In the manufacturing sector, 12 private domestic and 6 foreign companies were surveyed. In the agricultural sector, seven private domestic companies were surveyed. In total, we surveyed 39 domestic and 15 foreign companies in Kazakhstan, giving the Kazakhstan portion of our sample a composition of 72% domestic and 28% foreign companies. Overall, the sample almost fully represents the relative proportions of domestic and foreign capital in the economy, which are approximately 70% and 30%, respectively (Alshanov 2011).

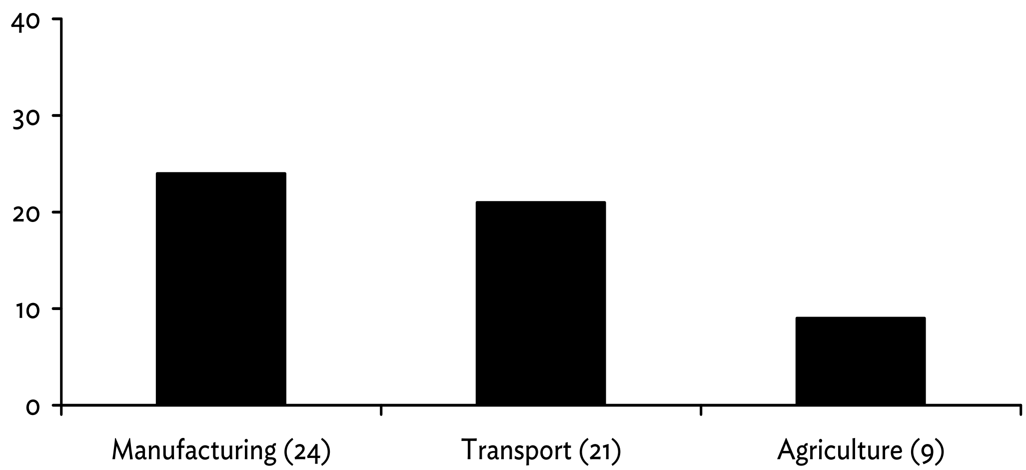
In total, 69 companies were approached, with 15 companies refusing to participate in our survey. As for regional representation, 40 surveys were conducted in Almaty and 14 in Astana (Figure 2). In Uzbekistan, 54 companies were surveyed in the three target industries (Figure 3).

Figure 2: Regional Representation in Kazakhstan



Source: Authors' compilation.

Figure 3: Survey Distribution by Industry in Uzbekistan

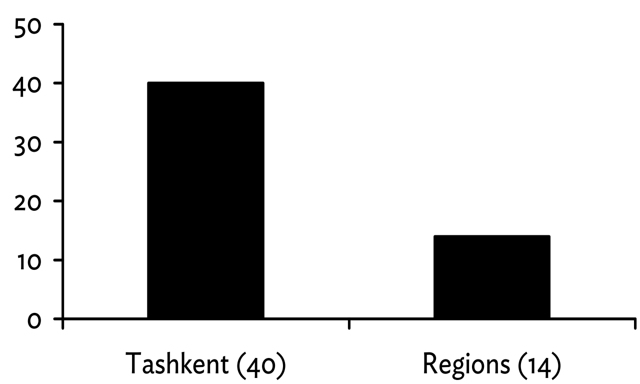


Source: Authors' compilation.

In Uzbekistan's manufacturing sector, 12 private domestic, 8 foreign, and 4 state-owned companies were surveyed. In the transport sector, 15 representatives of private domestic and 6 foreign companies were surveyed. In the agricultural sector, three private domestic and 6 state-owned companies were surveyed. In total, we surveyed 30 private domestic, 14 foreign, and 10 state-owned companies.

Overall, 75 companies were approached in Uzbekistan, with 21 companies refusing to participate in our survey. As for regional representation, 40 survey participants were from Tashkent and 14 were from other regions (Figure 4).

Figure 4: Regional Representation in Uzbekistan



Source: Authors' compilation.

3.3 Qualitative Data Analysis

After conducting the company surveys the next step data was to systematize and analyze the responses of the 108 survey participants. The analysis of 108 surveys provided comprehensive information on the existence and persistence of informal trade barriers. To elaborate on our survey findings, we also organized one roundtable discussion with 15 experts in Almaty, Kazakhstan in 2011. The roundtable discussion was driven by the following questions:

(i) How do you define informal barriers and their impact on cross-border trade?
(ii) Why do most Kazakhstani and Uzbek companies not actively participate in cross-border trade?

The survey included 4 main sections. First, we collected basic company information (e.g., year of establishment, size, number of employees, etc.). Second, we asked about the forms of cross-border trade the company is engaged in. Third, we collected information on the informal barriers encountered by companies when entering foreign markets. Fourth, we asked questions about the tools companies use to deal with these informal barriers.

After the companies had completed the surveys and assigned responses to the standardized questions, we had a sample of 108 companies with detailed information on their backgrounds and cross-border economic activity.

We acknowledge that the main challenge associated with quantitative analysis can be sample selection bias. In this case, such bias might manifest itself through the underrepresentation of firms not engaged in cross-border economic activity. However, we mitigated this concern by including companies that failed to pursue cross-border trade activity because of informal barriers.

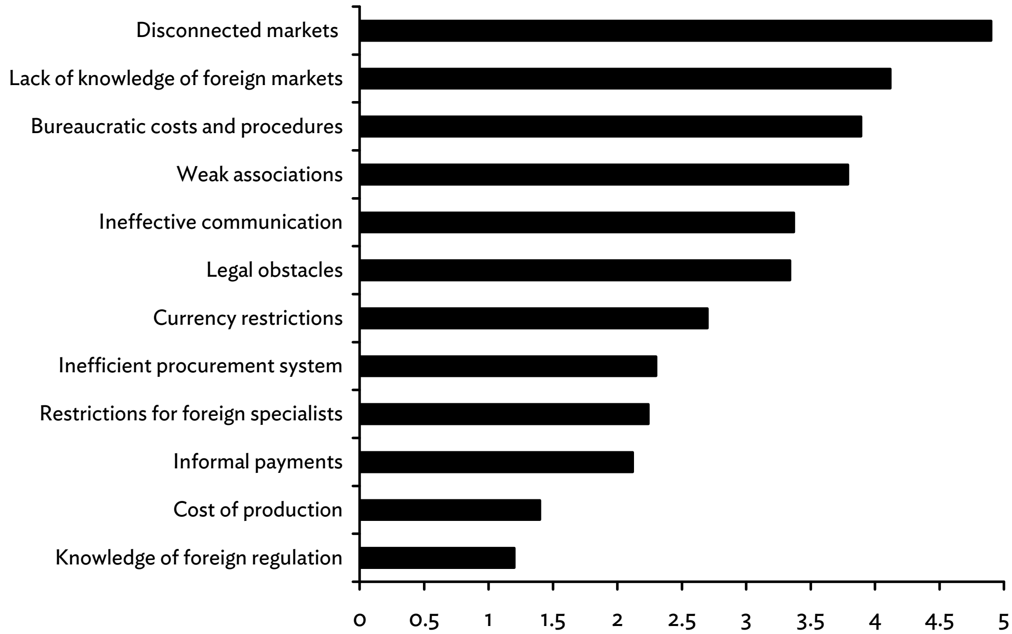
4. Discussion of results

4.1 Informal obstacles to cross-border economic activity

As mentioned in the literature review, while the BEEPS and World Bank Doing Business indicators identify formal barriers to cross-border trade and economic activity in both countries, in our paper we primarily focus on informal ones. Thus, our study should be viewed as complementary to the studies done by international organizations.

Surveying 108 companies in Kazakhstan and Uzbekistan, we calculated the average reply rate of respondents on existing informal barriers, which preclude them from cross-border trade and entering the markets of neighboring countries. Figure 5 shows the distribution of answers of respondents in Kazakhstan and Uzbekistan, representing the average rate on a scale from 0 to 6.

Figure 5: Informal Obstacles (aggregate distribution of answers; average mean)



Source: Authors' compilation.

As can be seen, the problems of disconnected markets and a lack of knowledge of foreign markets are viewed as the main informal obstacles hindering companies from more active expansion abroad. By disconnected markets, we imply markets in which economic actors are isolated from each other (in terms of information sharing and economic activity) to the extent that actors in one country do not consider the neighboring market as being complementary to their business activities due to disharmonized legislation between the two countries, insufficient information regarding market opportunities, and a general reluctance based on a condescending attitude toward the neighbouring country. Companies in the manufacturing, transport, and agriculture sectors simply do not possess relevant market information about the demand–supply situation in neighbouring countries. This serves as a barrier for them in entering foreign markets. These obstacles are closely interconnected, as disconnected regional markets in agriculture, for instance, result in a lack of information on market opportunities in other countries.

We can add the problems of weak associations and ineffective communication between companies, as they also reflect disconnected markets and a lack of knowledge of foreign markets. Respondents pointed out that the lack of effective associations, which would unite companies domestically and establish contacts with associations from the same industry in other countries, is a serious impediment to the expansion strategies of domestic companies. These associations could collect information about foreign markets, including the supply–demand situation, and then spread this information among domestic producers. Currently, companies in both countries resort to the use of bilateral mechanisms of communication, which the majority finds as being rather ineffective.

Assessing different trade challenges within the Aid for Trade program in Central Asia,[4] the International Trade Center (2008) notes that there is a lack of effective business associations in Central Asia that could otherwise fill knowledge gaps and provide sector-specific advice to private companies seeking to expand abroad. In addition, most of the business associations and consulting companies that do exist are located in big cities and are weakly represented in provinces. For instance, 62% of all consulting companies in Kazakhstan are located in Almaty, while the remaining 38% are evenly distributed across other regions and cities (BISAM 2010). This largely disproportionate distribution of consulting agencies serves as a serious obstacle for export-oriented companies in many parts of the country. Kazakhstani companies in the three industries under investigation that are based outside of Almaty have limited access to high-quality consulting services to help them successfully access foreign markets.

Another set of informal obstacles, which representatives of companies in both countries stressed, relates to excessive bureaucratic costs and procedures. Despite numerous state attempts to improve the business climate and ease the bureaucratic burden, companies still find these two problems to be significant factors in their hesitation to expand abroad. Legal obstacles belong to the same group of barriers. Despite the fact that companies in both countries are well aware of the peculiarities of foreign regulations—the least important barrier identified in Figure 5—when it comes to entering other markets they still have to deal with various legal barriers that can be interpreted by authorities differently than prescribed by the relevant laws.

Another formal and informal barrier is currency conversion and access to cash. However, it is necessary to point out that this is largely a problem for Uzbek companies, with companies in Kazakhstan not hindered by currency conversion restrictions. Companies in Kazakhstan also enjoy greater access to credit to finance foreign operations.

Those companies that pointed to excessive bureaucratic costs and procedures as a serious obstacle tended also to stress the importance of ineffective public procurement systems in neighboring countries. These barriers are interconnected with each other. Companies that engage in tenders in other countries are likely to face various bureaucratic issues and problems. Those companies that do not participate in public tenders in other countries tend not to underline the problem of excessive bureaucratic procedures as being a serious one.

Another important obstacle to expanding abroad is the problem of existing restrictions on foreign specialists, which is especially acute in Kazakhstan. For example, if an Uzbek company seeks to enter the Kazakhstani market, it has to deal with quota regulations placed on foreign labor, which often negatively influence the decision of a foreign company to enter the market.

[4] *Aid for Trade* was implemented in 2009–2013 in Armenia, Azerbaijan, Belarus, Georgia, Moldova, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan (Cukrowski 2011). The key aim of the program was to enhance companies' ability to trade domestically and internationally (International Trade Center 2011).

This is, however, somewhat less of a problem in Uzbekistan, which has a more liberal regime with respect to the regulation of foreign labor.

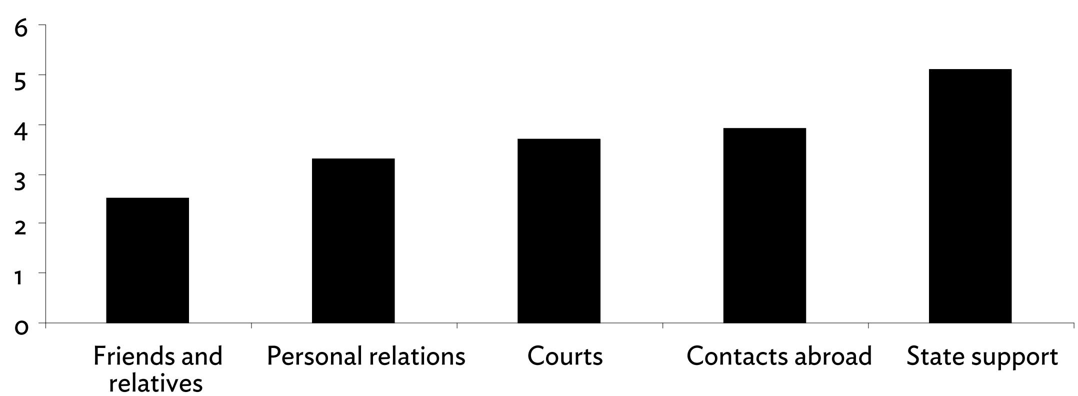
Another barrier is the need for informal payments to various stakeholders to engage in cross-border trade. Surprisingly, this barrier was not cited as being as important as one might expect given the prevalence of informal business practices in the region.

Last, but not least, companies in two countries identified the problem of high production and service costs in neighboring countries as the least important obstacle to entering foreign markets. Thus, this allows hypothesizing that production costs are relatively similar across all Central Asian republics.

4.2 Tools for overcoming informal barriers

How can private businesses ensure they follow a successful strategy and overcome informal barriers to cross-border trade? After analyzing the existence of informal barriers for cross-border trade and operations, it is necessary to report on the mechanisms and tools companies in both countries use to address them. Figure 6 shows the aggregate average reply rate on a scale from 0 to 6 for both countries with respect to solutions to informal obstacles.

Figure 6: Solutions to Informal Obstacles
(aggregate distribution of answers; average mean)



Source: Authors' compilation.

Resort to the use of friends and relatives is viewed as the least important mechanism when dealing with informal barriers. Personal relations with businesses and authorities in a home country are seen as a somewhat more effective mechanism. The majority of respondents view court mechanisms as an effective tool to overcome existing barriers. In fact, company representatives pointed to higher courts as more effective in addressing barriers. This view was also expressed by roundtable discussion participants. Yet, using courts is not as effective as resorting to the use of personal contacts abroad.

The most important mechanism for companies to deal with the most pressing informal barriers in cross-border trade is the use of various communication channels (various state-business associations, public–private partnerships, etc.) to gain state support. Companies seek to gain state support while lobbying for their interests with respect to entering foreign markets. Thus, it is necessary to account for the effects of communication between private businesses and the state. For most private companies, frequent communication with the state is indeed a key factor for success as communication channels help companies access state support.

As Table 2 indicates, the absolute majority of respondents (34 companies in Kazakhstan and 35 companies in Uzbekistan) rated the importance of governmental support as being crucial in overcoming informal barriers to entering foreign markets.

Seven companies in Kazakhstan and 8 companies in Uzbekistan saw communication channels with the state as important: if a private business faces an informal barrier it may either communicate directly with the state or resort to the use of other mechanisms. Of course, this requires having access to communication channels. Finally, 13 companies in Kazakhstan and 11 companies in Uzbekistan felt that communication with the state is not important and business can solve informal barriers without state support. These companies were all foreign, which is not surprising as foreign companies do not need the support of either the Kazakhstani or Uzbek governments to enter markets of other countries. However, they still need to communicate with the state in order to obtain necessary information about the development of a local market. For the majority of local companies governmental support and communication with the state are necessary conditions for overcoming existing informal obstacles to cross-border trade and successfully entering foreign markets.[5]

Table 2: Communication with the State

Communication with the state as a tool to overcome barriers		
Very important (5–6)	Important (3–4)	Not important (0–2)
Kazakhstan		
34 companies	7 companies	13 companies
Uzbekistan		
35 companies	8 companies	11 companies

Source: Authors' compilation.

[5] Communication with the state as a tool to overcome barriers presents the only clear pattern of differing attitudes between domestic and foreign companies included in our survey. Disaggregated results by industry, country, and type of firm (domestic or foreign) do not reveal any other clear patterns and largely reflect the aggregate results. This can also be explained by the relatively small sample size. Thus, except for the combined overview of disaggregated results in the category of communication with the state as a tool to overcome barriers (Table 2), the disaggregated results are not highlighted in the paper.

Why are these conditions so important? In our view, private businesses in Kazakhstan are not strong enough to be fully independent of the state. Domestic and foreign entrepreneurs may seek governmental support through various channels of communication at all levels of entrepreneurial activity, with the government playing a central role in coordinating economic processes.

Table 3 provides a summary of communication platforms and the degree of their effectiveness as assessed by survey respondents. As the table shows, the effectiveness of the state–business interaction in Kazakhstan depends on business size and the level of interaction; the higher the level, the more effectively barriers can be overcome. One of the most effective mechanisms that companies use is the American Chamber of Commerce, which brings representatives of various businesses from different countries together and facilitates communication with the state. This channel also helps companies collect information about other markets, partly solving the problem of disconnected markets. Representatives of the small and medium-sized enterprises emphasize the increasing importance of the Foundation for Small Business Support DAMU which plays a significant role in providing direct financing and helping private domestic companies successfully enter the foreign markets.[6]

Table 3: Respondents' Views on the Effectiveness of State–Business Interactions in Kazakhstan

Type of Business	Communication Platform with the State
Large Foreign Business	Very Effective American Chamber of Commerce, European Business Association of Kazakhstan (EUROBAK)
Large Domestic Business	Effective Ata-Meken, Forum of Entrepreneurs of Kazakhstan
Foreign SMEs	Somewhat Effective Foreign embassies and associations of entrepreneurs
Domestic SMEs	Somewhat Effective Foundation for Small Business Support DAMU

SME = small and medium-sized enterprises.

Source: Authors' compilation.

[6] Established in 1997, the Foundation for Small Business Support DAMU is aimed at enhancing the state support for boosting the development of small business in Kazakhstan. One of the main goals of the Foundation is to enhance the competitiveness and export capacity of medium-sized enterprises (DAMU 2014).

In Uzbekistan, communication platforms between the government and the private sector exist. However, they are mostly ad hoc in nature rather than being a regular fixture. Quite often these meetings are initiated by the government through *khokimiyats* (local mayor's offices) rather than being initiated by the private sector. Such meetings often have little or no use since attending entrepreneurs are usually gathered in a compulsory way and complaints are generally not well-received by government officials. As a result, entrepreneurs prefer to keep a low profile at such obligatory meetings. Although this procedure appears to encapsulate the main features of the former Soviet administrative system, it has been gradually changing with the introduction of civic hours, during which any entrepreneur may come and discuss issues with a particular public official. These meetings do not necessarily resolve the issues of entrepreneurs; however, this represents a positive initiative and a departure from the prior top-down administrative way of arranging meetings. On the other hand, representatives of the private sector can rarely initiate meetings with high-level public officials. In many countries this is done through professional associations with access to high-ranking public officials. However, in Uzbekistan these associations play little or no role. Therefore, private entrepreneurs have to rely on informal institutions, such as their personal and family contacts in the state sector, to assist them in resolving issues. This, in turn, creates a loophole for rent-seeking. As in Kazakhstan, large companies in Uzbekistan have a greater chance to resolve their issues with top-ranking officials than representatives of small and medium-sized enterprises (SMEs).

Public officials complain about possessing imperfect information on the actual needs and demands of the business sector, since they (private sector representatives) prefer to engage in the grey economy rather than combat existing challenges in a normative way. It may be concluded that an effective communication platform and proper dialogue between the private and the state sectors is still missing. The Chamber of Commerce and Industry of Uzbekistan was established as a nongovernment organization to fill in this gap. However, it primarily serves the interests of the state, although business interests are not entirely neglected.

Table 4 summarizes the effectiveness of public–private communication channels in Uzbekistan. As can be seen, different businesses enjoy different methods of access to the state and may use both formal and informal ways to achieve their goals. As in the case of Kazakhstan, the level at which state–business interaction takes place matters. The higher the level of interaction, the easier it is for companies to overcome informal obstacles.

Table 4: Respondents' Views of the Effectiveness of State–Business Communication in Uzbekistan

Type of Business	Formal Communication	Informal Communication
Large Domestic Business	These businesses mainly resort to established formal bilateral relationships and other channels such as government–business forums and the Chamber of Commerce and Industry of Uzbekistan. The state normally has an ownership share in the business.	Personal connections play a huge role. Quite often problems are resolved without using the official way, based on the principle "you scratch my back, and I will scratch yours."
Large Foreign Business	These businesses mainly resort to formal communication through established government channels, business forums, their embassies (if present in Uzbekistan), the American Chamber of Commerce, and (to a lesser extent) the Chamber of Commerce and Industry of Uzbekistan.	Informal communication generally not applicable in a foreign business' early years of operation in Uzbekistan. However, they gain importance as the business gets to know the role of informal networking and the rules of the game in general. In such cases, informal communication usually results in corruption.
Domestic SMEs	Domestic SMEs seek formal communication with the state through the Chamber of Commerce and Industry of Uzbekistan and civic hours for entrepreneurs in local *khokimiyats (local mayor's offices)* and respective ministries.	Informal mechanisms play an essential role in the well-being of SMEs. Most issues are resolved through personal and family connections. Petty corruption can often take place.
Foreign SMEs	Foreign SMEs usually have a representative office (to avoid profit conversion issues) and, therefore, have limited formal resources to rely on. Mainly, the resource of the American Chamber of Commerce in Uzbekistan is employed.	Informal mechanisms have little importance and may occur on an ad hoc basis (e.g., if a local employee happens to have good personal and/or family connections). Little or no corruption is evidenced.

SMEs = small and medium-sized enterprises.

Source: Authors' compilation.

5. Conclusion

Existing informal barriers encountered by companies in the agriculture, manufacturing, and transport industries in Kazakhstan and Uzbekistan when entering each other's markets are not always associated with the state influence. In fact, most problems are associated with disconnected markets, a lack of knowledge of foreign markets, weak associations, and ineffective communication between private companies. Government-induced barriers such as excessive bureaucratic costs and procedures, legal obstacles, currency restrictions, and foreign labor quotas are seen as somewhat less significant informal obstacles. However, when it comes to problem-solving mechanisms, reliance on governmental support is given major significance by a majority of companies in the two countries. This is in line with the findings of Vakulchuk et al. (2012), who found that the state that creates such problems is also the best instrument to solve them.

Local markets in Kazakhstan and Uzbekistan are not yet fully satiated and, therefore, many companies see little need to learn about neighbouring markets. Among the three selected industries, manufacturing has the highest potential for increased cross-border trade as the governments of both countries encourage export-related manufacturing as a source of foreign currency and to promote sustainable economic development. As companies tend to agree on the role of the government in expanding to other markets, it is very likely that manufacturing industries will find niche markets in neighboring countries. This growth, in turn, should be positively reflected in the exports of the transport sector as an essential means of delivering agricultural and manufactured goods across borders.

One important policy recommendation can be drawn from our study. Both private companies and the governments of Kazakhstan and Uzbekistan should combine their efforts toward addressing the lack of information about foreign markets. The establishment of business associations would partly solve this issue, as they can collect information about foreign markets and spread it among domestic companies in the agricultural, manufacturing, and transport sectors. Vakulchuk et al. (2012) made a similar recommendation to establish a business association among companies in the consulting industry and the Consortium of Consultants and Research Organizations in Kazakhstan was established in 2012 based on the results of that study. The consortium now serves as an important tool for consulting companies to obtain information about foreign markets and better prepare their entry strategies. In a similar vein, the creation of effective business associations in the three industries under investigation and other export-oriented industries would serve the purpose of filling information gaps with regard to foreign markets, thus contributing to addressing the problem of disconnected markets in Central Asia.

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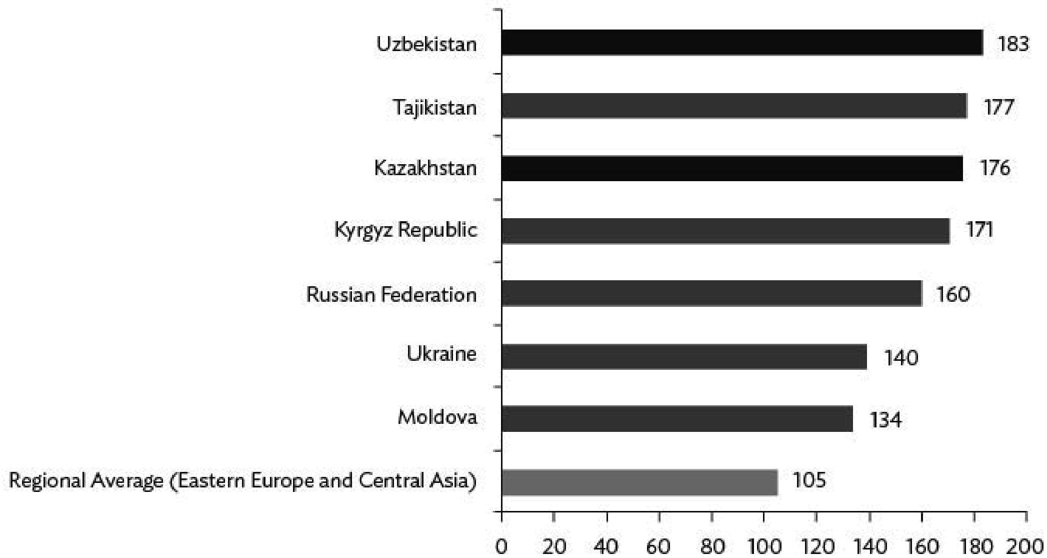
Appendix

Ease of Trading across Borders—Kazakhstan and Uzbekistan



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Analysis of Informal Obstacles to Cross-Border Economic Activity in Kazakhstan and Uzbekistan

While most studies on trade barriers worldwide—and in Central Asia in particular—focus on the role and impact of formal barriers from a macro perspective, this paper pays special attention to the role and influence of informal trade barriers from a micro (industry-specific) perspective in Kazakhstan and Uzbekistan. Moreover, the study depicts the measures employed by private companies to overcome existing hurdles to cross-border trade in the region.

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ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to approximately two-thirds of the world's poor: 1.6 billion people who live on less than $2 a day, with 733 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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