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THE RESOURCE EFFECT: CORRELATIONS BETWEEN EXPORTABLE RESOURCE RELIANCE, ECONOMIC POLICY, AND VARIOUS FREEDOMS IN THE FORMER SOVIET UNION

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Abstract

The purpose of this thesis is to examine the relationship between a state's possession of natural resources and its economic development. Known as the "resource effect," areas that are able to profit from exporting natural resources have less of an incentive to implement economic reform and subsequently democratize. This is due to several effects presented by M. Steven Fish (2005), which include a state's ability to provide government programs due to revenue, corruption, and the maintenance of opaque state ownership over fuel industries. As a result of these effects, the state does not need to encourage entrepreneurship through property rights, a sound banking system, and other institutional factors that allow for business and technological expansion. Instead, governments choose to withhold political rights and civil liberties in order to maintain their political position and safeguard control over resource revenue.

This paper focuses these theories on the former Soviet Union, specifically on six of the fifteen states that remained within the union at its collapse in 1991. Choosing Russia, Estonia, Armenia, Ukraine, Azerbaijan, and Kazakhstan, these states encompass the USSR's geographic diversity and represent states with and without natural resources. By offering an economic, political, and developmental overview of each state, the thesis shows that the Baltic states and others without resources tend to have higher freedom levels and a more solid financial system than those that have made a steady profit from natural resource exports. The thesis also draws upon Russia's role in stunting economic transitions based on its control over pipelines and massive fuel reserves.

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Acknowledgements

"You see, gentlemen, reason is an excellent thing, there's no disputing that, but reason is nothing but reason and satisfies only the rational side of man's nature, while will is a manifestation of the whole life, that is, of the whole human life including reason and all the impulses. And although our life, in this manifestation of it, is often worthless, yet it is life"

-Fyodor Dostoyevsky

Love you, Mom

Introduction

At the collapse of the Soviet Union in December of 1991, Russia and its fourteen sister states had to create autonomous governments with market economies after decades of being ruled by a system of central planning. I believe that the existence of exportable resources or a reliance on Russian resource imports within each state will correlate strongly with weak or failed economic policy within these transition economies. This occurs for several reasons, including the government's ability to provide social services with little taxation, using revenue to fund state security that can suppress opposition, and maintaining state ownership over resource industries, which promotes statism and stifles economic reform.

Because a state can maintain GDP through the control of resource revenue, it will not need to create a stable, business friendly economy in order to promote entrepreneurship and technological innovation. Political rights and civil liberties are purposely stifled in order to prevent opposition from forming which may demand government transparency and stable political institutions, jeopardizing government ownership. Therefore, the result of resource richness may be arbitrarily enforced laws which favor government elites over reform and economic stability.

Russian manipulation of the sale and transportation of oil and natural gas can also affect post-Soviet economic transitions. Referred to as the "Russia effect," this occurs when a state is either reliant on Russian fuel imports or pipelines than run through Russian soil. A state with outdated, inefficient capital can be pressured into supporting Russian policies in exchange for cheaper fuel imports. Also, the concentration of pipelines in Russian territory places a similar pressure on bordering states wishing to export oil or natural gas because Russia can charge higher fees for use of the pipelines or siphon off traveling oil or gas. Therefore, these states are at a disadvantage because of their proximity to Russia, which attempts to recreate their Former Soviet control through the "Russia effect."

After looking at a brief history of the Soviet Union's collapse, the level of exportable resources, economic policies, levels of freedom, and economic growth will be examined in six former Soviet states: Estonia, Russia, Ukraine, Armenia, Azerbaijan, and Kazakhstan. These states vary in possession of resources and proximity to Russia, making them a near-ideal sample of countries. Each state has been given its own profile examining its post-Soviet changes and connection to the central thesis. Following these profiles, graphical comparisons will be made in order to observe a relationship between resource factors and freedoms.

A Brief History

Peter Kenez wrote in A History of the Soviet Reform from Beginning to End, "Politicians, statesmen, and revolutionaries never actually accomplish what they set out to do… No one, including Gorbachev, could have foreseen the magnitude of the changes the country was embarking on" (Kenez 1999, 246). When Mikhail Gorbachev became general secretary in 1985, it was not his intention to completely democratize the Soviet Union, but to encourage communication and repair some of the inefficiencies he had witness in the agricultural sector (Kenez 1999, 247). However, the technological lags and the economic downturns of the 1970s created angst among the Soviet population that only drastic reform and the end of a planned economy could fix. Gorbachev's liberalization backfired on the communist party, opening the floodgates for decades of unrest to come forth. His leniency with Poland and the other Warsaw Pact states sparked a chain reaction that led the Soviet Union's collapse and the beginning of economic reform for the commonwealth of independent states (CIS).

With an inviting, affable personality, Gorbachev quickly rose through the ranks of the communist party, earning him a seat in the Politburo, its executive committee, in 1979 (Kenez 1999, 247). Due to a string of ill party leaders, he became General Secretary of the Communist Party of the Soviet Union in 1985 (Kenez 1999, 244). Unaware of the consequences that his reforms would have, he believed that liberalization was needed maintenance, rather than a revolution, stating in a speech that “we stand not on some slippery swamp, but on firm ground that has been formed through the efforts of many generations of Soviet people” (Breslauer 2002, 64).

Under the terms “perestroika” and “glastnost,” meaning restructuring and openness, respectively, Gorbachev implemented drastic liberalization policies using catchphrases often used by Stalin and sunsequent Soviet leaders (Siegelbaum 2011). During the first two years of his term, he implemented policies spanning areas of free speech, economic expansion, and foreign policy. The most radical policy on the social level was glasnost, which allowed for open debate of political issues in order to develop “a more vibrant, dynamic and efficient society” (Breslauer 2002, 66). As a result, artists, filmmakers, journalists, academics, and activists received a voice in Soviet politics, creating a stronger constituency which would demand more and more proof of government legitimacy (Breslauer 2002, 61).

Economically, Gorbachev attempted to increase factory efficiency by improving both the facilities and the workforce. In an attempt to deal with the technological gap between the Soviet Union and the West, he restructured investment in order to focus on more modern facilities, rather than adding or renewing old equipment. In regards to the labor force, Gorbachev launched a massive anti-alcohol campaign, trying to curb infant mortality, declining life expectancy, crime, and drinking on the job. This plan proved costly for the Soviet Union financially and publicly. It was not only extremely unpopular, but denied the government a substantial amount of revenue once made from the increased sale of alcohol (Kenez 1995, 250). Although this policy was not successful, it was not enough to remove Gorbachev from power. Liberalization continued and several more changes occurred before the fall of communism took place.

Gorbachev continued with the theme of open mindedness in perestroika's foreign policy. Under the title of "new thinking," he stressed a more liberal approach, calling for cooperation among all of Europe in a relationship of mutual security. Perhaps the most inventive facet of this strategy was the idea that cooperating with capitalist nations would benefit the Soviet Union because the West would be denied their "enemy image" (Breslauer 2002, 72-3). To back up this new attitude, Gorbachev agreed to remove intermediate nuclear weapons under the IMF Treaty with the United States in December, 1987. He also withdrew troops from Afghanistan in May 1989 and agreed to stop further military intervention in Eastern Europe, which had dramatic consequences at the end of his terms (Breslauer 2002, 60).

Despite the intentions of these policies, allowing anti-government opposition to mobilize proved too much for the Soviet Union to handle. This is largely due to the economic hardship that preceded glasnost and perestroika and the inability of a planned economy to match the innovation of Western Europe and the United States. Ivan T. Behrend of UCLA wrote in his book, From the Soviet Bloc to the European Union, that the collapse of the Soviet Union "was neither predicted nor believable" (2009, 1). Behrend, who was involved with Hungary's liberalization policy, accounts for several global economic shocks that not only affected the Soviet Union's economy, but inspired technological changes in the West's recovery period that a socialist regime would not easily match.

A major blow to Soviet industry was the oil crisis of 1973, which was caused by the Yom Kippur War against Israel and the subsequent boycott of the Organization of Petroleum Exporting Countries (OPEC). The Iranian Revolution in 1979 created a second "oil crisis" through 1980, culminating in the world's first experience with stagflation (Behrend 2009, 7). Because Poland and other states were already heavy trading partners with free economies, the Soviet bloc was not spared from the economic turmoil (Behrend 2009, 20). However, what was most important about these events was not the temporary downturn, but the exposure of the union's obsolete technology.

The Soviet method of coupling energy-intensive industry with large labor inputs was no longer a viable method after these oil shocks not only due to its inefficiency, but the way in which free economies evolved as a result of the shocks. Behrend wrote that "neither the Soviet Union nor its satellites were able to adjust to the new technological requirements of the communications and service revolution of 1973" (2009, 23). Referencing Joseph Schumpeter, Behrend explains the Soviet Union's lack of entrepreneurial incentives that would bring about technological development and Schumpeter's essential Creative Destruction (Behrend 2009, 25).

This lag in Soviet output, coupled with glasnost and perestroika, led to a chain reaction that began with Poland's Solidarity movement in 1980 and ended with the dissolution of the entire union in 1991. Because Gorbachev's policies allowed for elections on the regional level, anti-communist parties were allowed to legitimately establish themselves in several areas. Poland began to mobilize thousands as part of the movement, while remaining open to discussions with Gorbachev. Continuing with his New Order of foreign policy, Gorbachev announced to the United Nations on December 7, 1988 "Today I can inform you of the following… we have made the decision to withdraw six tank divisions from the GDR, Czechoslovakia, and Hungary, and to disband them by 1991." This sent a shockwave through Poland, Hungary, Czechoslovakia, and East Germany as opposition parties began taking over regional government and borders began to open. After announcing that Poland and Hungary were allowed to follow their own path, he extended this to the remaining Warsaw Pact nations in October (Smitha 2011).

Even before becoming Russia's regional president, Boris Yeltsin had told other regions across the USSR to "grab as much autonomy as you can hold" (Shchedrov 2009). He would be able to utilize this attitude in a profound way after the attempted coup against Gorbachev that took place on August 18, 1989. Yeltsin, standing proudly on a tank in front of the capital, renounced the perpetrators, gained mass public support, and with it, power over Gorbachev. Following states from the Baltic region, several others began calling for independence. Yeltsin met with leaders of Ukraine and Belarus and on December 8, they declared that the USSR would become the Commonwealth of Independent States (CIS). On New Year's Eve, Gorbachev resigned (Leonard 2006, 713).

Transition Economics and Resource Effects

This section will review some of the early literature on transition economics that emerged in the 1990s, as well as a more recent text that explores the connection between resource endowments and slow reform. These sources will place the historical content from the previous section into a theoretical framework, which will allow for a more informed interpretation of the following country profiles.

In the 1996 *Journal of Economic Perspectives*, several scholars evaluate the pre-1996 progress that has occurred in the former Soviet Union and offer their opinions on what still needs to be done. Murell, Brada, Rapaczynski, and Ficsher et al. examine different facets of post-

Soviet transitions, including methods of privatization, the establishment of property rights, and whether currency stabilization is necessary for economic growth. A quick overview of their thoughts and findings will offer insight into the transitional tasks and problems specific to the Commonwealth of Independent States, allowing us to gauge how each state has tackled these issues.

The article by Peter Murrell, *How Far Has the Transition Progressed*, gives a general overview of the economic and political struggles in the former Soviet Union, as well as some economic indicators of that time period. He is quick to establish a link between political and economic reform, especially in the case of the former Soviet Union. Because its past was centered on state ownership, he claims that "there is a much different atmosphere of interaction between government and individual economic agents in ex-socialist countries" (Murrell 1996, 32). However, he still believes that reform is dependent on the core processes of political and economic competition, which stand upon a solid institutional foundation (Murrell 1996, 41). Thus, "the outliers in politics are usually the outliers in economics" (Murrell 1996, 31).

In order to begin the reform process, Murrell (1996, 33) believes that an important first step in building solid institutions is to "settle the relationships among elected leaders, the legislature and the bureaucracy," usually by making the bureaucracy subservient to the politicians and dividing responsibilities between executives and legislatures. The bureaucracy also needs extreme restructuring, as they often resemble inefficient Soviet industries (Murrell 1996, 34). However, he states that while restructuring is dire, it has not been a major focus of reform, leaving political bodies that have the potential to create contradictory rules and fail to follow through on necessary initiatives (Murrell 1996, 33). As a result, even when reform measures are approved, the chance exists that they will not be effectively implemented.

Murrell also mentions some reasons for stunted reform which are relevant in the following country profiles. These are war and location, meaning more specifically whether a state is landlocked (Murrell 1996, 31). Both of these factors exist in Armenia's conflict with Azerbaijan. While Azerbaijan falls on the Caspian Sea and is able to support itself from oil revenues, Armenia is landlocked, unable to trade due to closed borders and limited resources. Looking at data until 1994, Murrell (1996, 44) observed that countries not affected by war made substantially more progress in terms of reform. He also lists personal politics as a major deterrent of reform, which is most strongly applicable in Ukraine. On this matter, he states that "even in the most advanced reforming countries, ephemeral political squabbles threaten important democratic gains" (Murrell 1996, 29).

Despite these limitations, some progress has been made. Murrell (1996, 31) states that out of the many dimensions of liberalization, freeing internal markets had proceeded the farthest in post-Soviet states. While this has created some threatening fluctuations in each economy, improvement have been seen. In terms of output, Murrell believes that the sharp decline is an expected event of the liberalization process, even though output has fallen by unprecedented amounts (Murrell 1996, 37). Between 1989 and 1994, the average budget deficit peaked at 14.4 percent of GDP, which includes countries like Poland and Hungary, but fell to 6.3 by the end of this time period (Murrell 1996, 36). Most republics still experienced declining GDP in 1995, but not as severely as previous years (Murrell 1996, 37). To combat these fluctuations, many states have turned to large subsidies, sometimes equaling 2% of GDP, but this level is also declining (Murrell 1996, 36).

In next article, *Privatization is Transition—Or is it*, Josef C. Brada illustrates the complexities of the privatization process, stressing that there is no perfect method. However, it is a process that must be undertaken because it subjects enterprises to private ownership, which can increase productivity by motivating managers and attracting prospective owners to the markets with the most need. Brada (1996, 68) states that this will "unleash dynamic small businesses, act as a lure for foreign direct investment and speed the painful process of restructuring industry." It also has the benefits of returning pre-communist property to its rightful owners and raising revenue for the government. He also claims that privatization will help to solidify property rights because new owners will demand them, which is a central theme of the Rapaczynski article (Brada 1996, 67).

However, these benefits are difficult to achieve due to the infancy of new market economies and their institutions. For example, the lack of a free market makes valuing firms difficult, citizens usually lack sufficient savings to make an investment, and banking systems do not have the structure to make secure loans (Brada 1996, 68). This lack of stability also deters foreign investors, who do not wish to hold such ambiguous assets. Due the lack of buyers, governments may have to rely on selling firms at preferential prices to insiders (Brada 1996, 72). This is what occurred in Azerbaijan and Russia under the voucher system, where savvy insiders were able to gain the most shares of the most lucrative industries (Brada 1996, 74).

Therefore, honest attempts to privatize may result in an unsatisfying mixture of market-oriented small business and foreign-owned firms, along with former state-owned firms that have difficulty dropping their Soviet managerial styles (Brada 1996, 84). To all of these obstacles, Brada concludes that "grand designs for privatization cannot be drawn up," stressing that a broad range of methods must be used to get through this arduous process (Brada 1996, 84).

The next topic from this journal deals with the establishment of reliable property rights, or "enforceable entitlements." Andrzej Rapaczynski (1996, 87) presents his idea that a system of enforceable entitlements "is in fact largely a product of market forces, rather than government fiat," because "the core of the institution of ownership is a matter of unquestioned and largely unconscious social and economic practices" (Rapaczynski 1996, 88). However, this process cannot take place in the former Soviet Union because an immense amount of capital stock already exists from previous industrialization without any legal basis for private ownership (Rapaczynski 1996, 91). This process is further complicated by Soviet ideology, which promoted collectivization (Rapaczynski 1996, 97).

Suspicions about a state's ability to enforce property rights can deter investment and prevent social enforcement of entitlements. Governments that are unable to follow through on enforcing new laws or choose not to follow them create an environment of mistrust. Rapaczynski states that "how effective [a] state's (largely nonlegal) commitment is to their security is a more serious problem than the issue of legal protections against the more traditional forms of takings," and that an effective system of property rights is almost impossible to implement when the state lacks credibility (Rapaczynski 1996, 93).

Although his article lacks optimism, Rapaczynski does offer some advice. Rather than laying down a basic legal framework and waiting for property owners to demand enforcement, "an advanced form of a market economy, together with its complex institutions, must be created in an unusually short period of time" (Rapaczynski 1996, 91). The rapidity that he is suggesting is important to keep in mind during the country profile section.

Lastly from *The Journal of Economic Perspectives*, Fischer, Sahay, and Vegh examine the relationship between currency stabilization and growth. While some theorists believe that high inflation must exist so that new businesses can have access to cheap credit, they find that annual inflation should be less than 50% in order for growth to begin (Fischer, Sahay, and Vegh

1996, 63). However, this is under the assumption that a state striving for stabilization will also be ambitious towards other reforms, and that states that do so can begin to see growth within two years (Fischer et al. 1996, 64). They also see a correlation between growth and a pegged exchange rate, because this can reduce inflation (Fischer et al. 1996, 47).

In the final text to be discussed, Democracy Derailed in Russia, M. Stephen Fish explores several explanations to Russia's weak levels of freedom, despite its economic success. In this discussion, Fish (2005, 114) states that, in general, "natural superabundance is usually one of democracy's worst antagonists." From this starting point, he looks at existing theories as to why this is case, beginning with three: the rentier effect, the repression effect, and the modernization effect. While these are the most common, he also includes the corruption effect and the economic policy effect, which are especially applicable to our states in question.

The rentier effect refers to "a government's ability to provide popular social services and patronage while taxing populations lightly or not at all" (Fish 2005, 116). These services are usually funded by fuel revenues, which appease the population into complacency and diffuse pressure to democratize. Therefore, a state with high resource endowments, an appealing level of social spending, but low levels of taxation may be able to blame this effect for stalled democratization.

The repression effect, while difficult to prove, gives the possibility that resource revenue could be used as "government expenditures on the secret police and other internal security organs" (Fish 2005, 122). These organs maintain a coercive structure that does not allow for the articulation of opinion or the formation of an opposition force which can advocate for democracy. Due to the opacity of this spending, however, the repression theory is difficult to prove. Fish believes that increased military spending may be a useful indicator (Fish 2005, 122).

Thirdly, the modernization effect states that "natural resource abundance may boost income without inducing the social, cultural, and economic changes that often accompany rising wealth" (Fish 2005, 124). This logic behind this effect is that a more "high-culture, highly educated, highly industrialized society" will be more driven to democratize, but states that slow income per capita growth from fuel revenues may not necessarily create this type of society (Fish 2005, 125). While Fish does not spell out exactly why income growth outside of resource revenue would create a more involved society, it may be that alternative economic growth relies upon entrepreneurship and technological expansion, rather than natural endowments. This risk taking would need to emerge from a more educated, flexible society, which a government could choose to facilitate or suppress. I find this to be an especially compelling argument in regards to the former Soviet Union.

Next is the corruption effect, which is also applicable to several of our states. In this effect, politics is entrenched in dominant economic sectors, whereby politics are reduced to a struggle over unlawful control over these sectors. Even though lucrative industries have been privatized, a lack of property rights or enforcement of them renders the privatization useless (Fish 2005, 127). Thus, the goal of public servants becomes the attainment of corrupt control, rather than economic or political reform. He also addresses the point that the extraction and refinement of fuel, especially hydrocarbons, are capital intensive, and that labor involved are usually paid well enough to turn a blind eye to such practices (Fish 2005, 128). In Fish's own regression analysis, he finds that not only do natural resources produce corrupt governments, and that this corruption results in lower levels of political openness (Fish 2005, 130).

Finally, the economic policy effect, Fish examines Samuel Huntington's theory that resource richness encourages economic statism, and that this control over the economy prevents democratization because "economic free is strongly and positively related to political openness" (Fish 2005, 135). This is similar to the corruption effect, except in this case the state skips privatization in favor of direct control. Even if other sectors of the economy are privatized, holding on to the largest and most lucrative withhold these crucial industries from the new market economy.

Country Profiles

The following section will explore each of the six states chosen for our analysis, which were selected geographically out of the fifteen states that comprised the Soviet Union at its collapse in 1991. In addition to Russia, one state was chosen from each geographic cluster, with the exception of the Caucasus. In order to represent all areas of the resource spectrum, Estonia was chosen from the Baltics, followed by Ukraine from the European Former Soviet Union (FSU), and Armenia from the Caucasus region in order to represent areas with low levels of natural resource exports. Those with higher levels are Azerbaijan from the Caucasus region, Russia, and Kazakhstan of Central Asia. It is important to note that while the most authoritarian, oil-reliant regimes are within Central Asia, a lack of World Bank data makes them poor choices.

For each country examined, I will provide a general overview of basic statistics, first covering land size, population, and gross domestic product. Percentages of the population working in certain sectors will also be provided, data permitting. A graph will be given showing the percentage distributions of each state's four major exports: manufactures, fuel, agriculture, and ores and minerals, as well as a brief description of the state's industry. Then, I will transition into economic policy and practices, giving a brief history of the measures taken by each state after the Soviet Union's collapse. Finally, the results section will give some indicators of standard of living, including changes in GDP per capita, life expectancy, and foreign direct investment. After the country profile section, there will be a short cross-comparison section between the states to see if data and freedom rankings correspond with the thesis discussed above.

Freedom Indicators

Several measurements have been taken and manipulated by both governmental and nongovernmental organizations such as the World Bank, Freedom House Index, and the Heritage Foundation in order to evaluate the outcome of these new governments. From Freedom House, measures of civil rights and civil liberties will be used to get a general sense of where each state stands democratically. Political Rights refer to the people's ability to participate in government, which includes "the right to vote freely for distinct alternatives in legitimate elections, compete for public office, [and] join political parties and organizations" (Freedom House 2010). Civil Liberties include "the freedoms of expression and belief, associational and organizational rights, rule of law, and personal autonomy without interference from the state" (Freedom House 2010).

Both measures are on a scale between one and seven, with one being the most democratic and seven being the least. Scores are determined based on a checklist of ten political rights questions and fifteen civil liberties questions, which are individually scored on a scale between one and four. Two examples of political rights questions involve the probability of an opposition party gaining power through elections and whether political choices are dominated by military groups or economic oligarchies. Examples of civil liberties questions involve the existence of free media, religious and academic institutions, as well as freedom of assembly and union formation (Freedom House 2010). For a brief list of what characterizes each final rating between one and seven, see Appendix A.

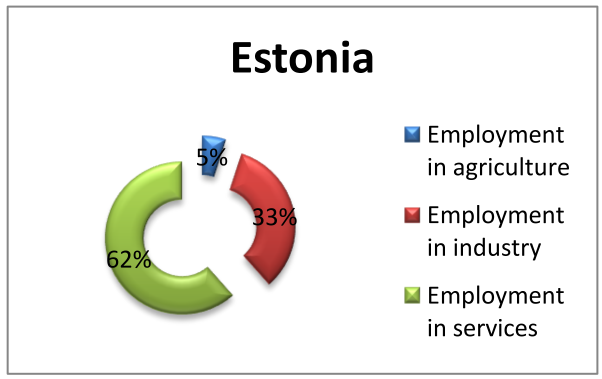
The Heritage Foundation (2011) uses World Bank data among other sources to give scores between 0 and 100 to ten different economic categories, with 100 being the most free. These ten scores are then averaged to find the state's overall economic freedom score. Because property rights and freedom from corruption are often the weakest components of an authoritarian state, these are the two primary measures that will be used for comparison, along with the overall score. For a basic description of what constitutes each property rights score, see Appendix B. The freedom from corruption score is taken from Transparency International's Corruption Perceptions Index (CPI) from 2009. The Index uses a rating scale between 0 and 10, which is then multiplied by 10 to match the scale of the Heritage Foundation. Other economic freedom components include business freedom, trade freedom, investment freedom, government spending, and monetary and fiscal freedom (Heritage Foundation 2011).

The Reporters without Borders Freedom of the Press Index uses 43 criteria that are used to assess press freedom over the past year. It includes violations against journalists, such as murders, attacks, threats, and imprisonments, as well as censorship and the confiscation of news sources. It also investigates the level of self-censorship, financial pressure, Internet censorship, and laws concerning the media, which includes whether monopolies are permitted. Of the 43 questions, most are answered either yes or no, with others scored between 0 and 5 on a scale. If an answer indicates that an injustice has taken place, points are added to the total. Therefore, a perfect freedom of the press score is zero. For example, if a journalist was placed under surveillance by either wire tapping or being followed, one point would be added. Other questions result in two or three points, which include whether privately-owned television stations exists, as well as kidnapping or disappearances of journalists (Reporter without Borders 2010).

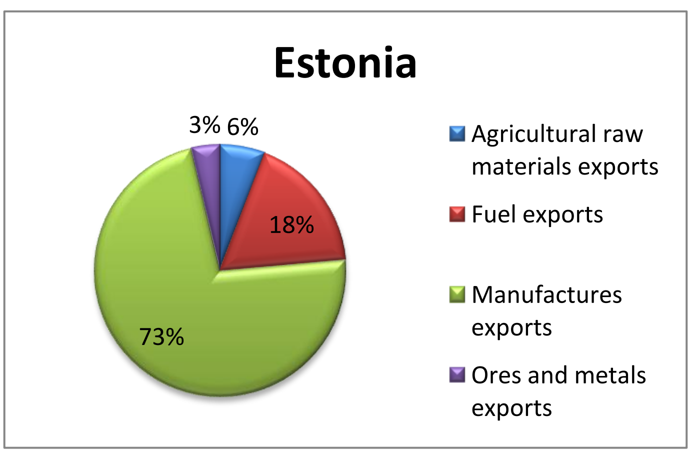
Both graphs in the country profile section are created using World Bank data from 2006, which was chosen due to the availability of data. The exports graph does not account for each state's total exports, but is a percentage of the state's total merchandise exports, which excludes services. Some categories have been omitted due to missing data in other states, but would have comprised a minimal portion of the graph and are not considered to be natural resources or manufactures.

Estonia

Estonia, Latvia, and Lithuania are the most economically Westernized states in the Former Soviet Union, comprising what is known as the Baltics. Small in size, Estonia has a land area of 42,390 square kilometers and a population of roughly 1.3 million. Of this population, approximately 5.9% was unemployed in 2006. A majority of the labor force works in the service industry, with about one-third in industry and only about 5% in agriculture. This already indicates higher economic development, due to the demand for services and high dependency on trade. In 2006, exports accounted for a massive 80% of GDP (World Bank Group, 2011).



Graph 1.1 Source: World Bank Group, World Development Indicators 2010



Graph 1.2 Source: World Bank Group, World Development Indicators 2010. All measurements are percentages of total merchandise exports.

Evident in Graph 1.2, a large proportion of Estonia's exports stem from manufacturing, accounting for almost 75% of the pie, which also showcases the country's level of technological development. According to the World Bank (2011), over 20% of manufactures exports are considered to be "high technology," while the other manufacture-dominant states do not exceed 4%. Encyclopedia of the Nations (2011) reports that Estonia's most important export is electronics, followed by cork and wood manufactures, as well as apparel, textiles, and furniture. Given this information, we would expect Estonia to be advanced in its levels of democracy and economic freedom in order to allow for such technological advances to take place. Given that Estonia and its sister states were hungry for independence at the fall of the USSR, their economic policy may be just as ambitious.

Economic Policy

According to Fredrick Erixon of the European Centre for International Political Economy, Estonia began economic reform prior to the collapse of the Former Soviet Union. Due to Mikhail Gorbachev's policies of glasnost and perestroika, regions were given some control over its political, social, and economic policy. Estonia's top leader, Indrek Toome, decided to take a step in 1989 that Boris Yeltsin would not be able to take in Russia for two more years. At the time, about 90% of Estonia's prices were fixed, greatly distorting demand to allow for government planning in supply. Toome began the painful process of freeing prices by reducing this amount to 60%, liberalizing the economy incrementally and getting a head start on the rest of the Soviet Union (Erixon 2010, 8).

Because part of perestroika included free elections for regional prime ministers, Estonia was able to elect a more radical reformer in 1990, Edgar Savisaar. Although his idea of reform attempted to find a middle ground between socialism and capitalism, his policies included further price liberalization, bringing the amount of fixed-price goods down to 10% (Erixon 2010, 8).

Despite the fact that supply was still largely controlled by the central government, this was an important step in a region where price subsidies accounted for 15% of GDP (Erixon 2010, 9). Estonia also beat Yeltsin to the punch with an attempt to privatize, although a lack of a legal framework regarding property rights and other implications complicated the process. This regional regime also attempted to encourage new business formation, but a lack of financial resources stalled the effort.

Early liberalization took its toll on Estonia at the Soviet Union's Collapse in 1991, which was made worse when Russia liberalized prices in almost one fell swoop in 1992. This created a massive deficit from subsidizing needed goods whose high prices made them inaccessible after hyperinflation increased the prices by over 1000% (Erixon 2010, 11). However, Estonia was able to mitigate this problem within months, leading the newly independent state towards economic growth faster than almost all other former Soviet states. Part of this solution was leaving the "ruble zone" and establishing an Estonian currency, the kroon (Erixon 2010, 15). This would allow Estonia to escape some of the consequences of Russia's price liberalization and ruble shortages that followed. If this change had not been made, Estonia would have suffered as the value of the ruble continued to fall another 600% over the following year (Erixon 2010, 16).

In order to make this change, Estonia established a currency board, which is responsible for issuing currency, but does not play a role in targeting inflation or lending to businesses in need. Instead, the amount of currency available depends on the amount of foreign reserves, which also determines the value of the currency (Heakal 2010). The German mark was chosen as the anchor currency, which would allow for stability, as well as an ease of trade with Europe.

Also, Estonian currency was purposefully undervalued at a proportion of 8:1, making trade more attractive (Erixon 2010, 22).

While this system did remove some monetary flexibility, it also carried many benefits in an unstable economy. In a situation where political leaders had little knowledge of and experience with a market economy, this rigidity allowed for some control over inflation and also allowed for greater confidence within a shaken society (Erixon 2010, 22). This strict reform was especially important given the economic hardship that was to come. If flexibility was allowed for, the new currency would have likely been abused into a massive deficit (Erixon 2010, 25).

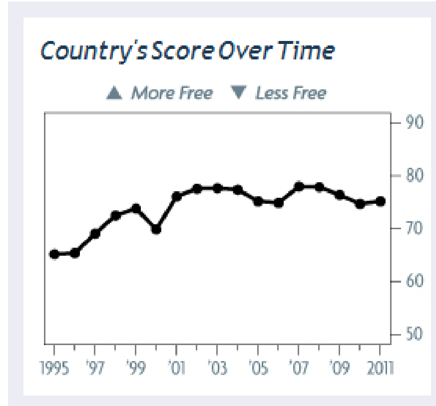
Estonia enforced this rigid structure by establishing a Stabilization Reserve Fund in 1997, which is comprised of the savings from budget surpluses and revenues from privatization, and is then invested abroad (Erixon 2010, 27). This fund would not only help cushion financial crisis without compromising the country's conservative fiscal and monetary stance, but would also allow for the accumulation of a pension fund, and allow the government to control expanding liquidity that resulted from credit growth (Erixson 2010, 27).

Together, these policies built a stable base for Estonia to flourish in the following years. Economic stability coupled with the enforced property rights and other freedoms gave Estonians the resources needed to take risks and create a state thriving on technology, which is not only within its borders, but exported for profit around the world.

Estonian Freedoms

Not only was new economic policy created promptly after 1991, but a new constitution was enacted that allowed for free and fair elections as early as 1992. Estonia even established Internet voting in 2007. Because of this, Freedom House (2010) considers Estonia to be an electoral democracy, receiving the highest score in both civil rights and civil liberties. The

Heritage Foundation's (2011) studies on business freedom report that "property rights and contracts are enforced, and the commercial code is applied consistently," giving them a property rights score of 80, far above the world average of 43.6. Even with some instances of corruption, the country still ranks 14th worldwide in terms of overall economic freedom, scoring over fifteen points above the world average. Looking at Graph 1.3, Estonia's economic freedom has been relatively consistent over the past decade, slightly increasing despite some slight fluctuations.



Graph 1.3 Source: The Heritage Foundation 2011

Freedom of the press is instilled in Chapter II, § 45 of Estonia's Constitution, which states that "Everyone shall have the right to freely circulate ideas, opinions, persuasions, and other information by word, print, picture and other means" (The Republic of Estonia 1992). Because this philosophy has been enforced, Estonia has been ranked 9th out of 178 states ranked in Reporters without Border's (2010) Press Freedom Index. The United States falls behind Estonia's journalistic freedom, ranking 20th.

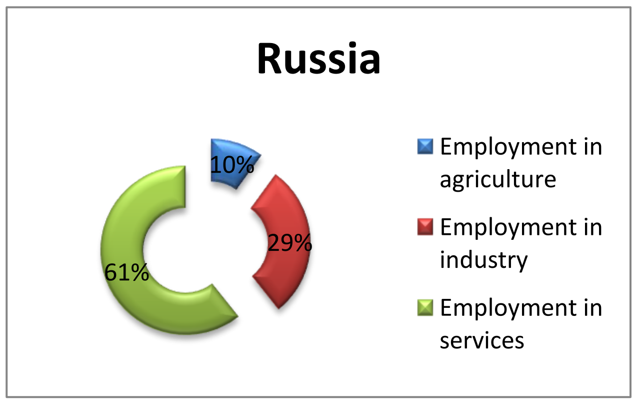
The Result

By beginning reform before the Soviet Union's collapse and remaining committed to the creation of a market economy, Estonia has become one of the biggest success stories of the Former Soviet Union. Examining rough indicators of an Estonian's standard of living, GDP per capita in 2006 was about 6,985.47 in constant 2000 U.S. dollars, almost doubling from $3,534.62 in 1991. Life expectancy hovers around 72.8 years with infant mortality at about 5.3 per every 1,000 live births, which dropped from 13.4 in 1995. It is also worth noting that foreign direct investment accounted for over 10% of the country's GDP in 2006, and number far exceeding the other states (World Bank Group 2011).

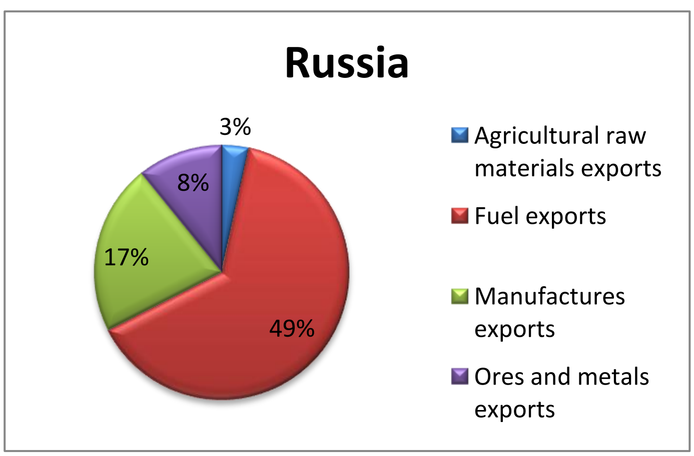
Levels of freedom rival the United States, creating a strong foundation for entrepreneurship and innovation, as well as foreign investment. It appears that each author in the literature review section would be proud of Estonia's rapid reform, stabilization of currency, commitment to privatization, and stable property rights. This is not surprising given the state's minimal resource endowment, which sparked the need to reform and helped to minimize distractions along the way.

Russia

Russia, by far the largest state to be examined, has a massive land area of 16.3 million square kilometers and a population of 142.5 million as of 2006. At this time, Russia had an unemployment rate of about 7.2%, with about 60% of the labor force employed in the service sector, 30% in industry, and 10% in agriculture. Likely due to the country's size, exports accounted for 33.7% of GDP in 2007, a moderate proportion in comparison to other post-Soviet states (World Bank Group 2011).



Graph 1.4 Source: World Bank Group, World Development Indicators 2010



Graph 1.5 Source: World Bank Group, World Development Indicators 2010. All measurements are percentages of total merchandise exports.

Looking at Graph 1.5, manufactures account for a much smaller portion of exports in comparison to natural resources. A country study done by the U.S. Congress reports that Russia is responsible for roughly 20% of the world's production of oil and natural gas, most of which currently comes from Siberia (Cooper 1996).

The "Russia Effect"

A large proportion of Russia's economy stems from the buying, selling, and transporting of natural resources, which gives this country massive leverage over any post-Soviet state that relies on Russia as a buyer or seller of oil or natural gas. In this respect, a state's natural resources are not the only resource-related determinant of economic development, but the resources of surrounding states that are needed to fuel the domestic economy. Today, Russia possesses a large amount of leverage because of their domestic resources, their demand for resources from neighboring states, and their pipeline ownership inside and outside of its territory. It is important to discuss Russia prior to the following states because of this dependency on Russia as a trade partner. For several states, this dependency has not wavered since the union's collapse due to energy intensive industries or the location of pipelines, forcing states to comply with Russian policy demands and affecting overall transitions across the Soviet bloc.

Bertil Nygren from Stockholm University examined Russia's resources relationship in his article "Putin's Use of Natural Gas to Reintegrate the CIS Region" (2008). He claims that "state-controlled energy companies are being used as proxy agents of foreign policy to punish or reward CIS neighbors" (Nygren 2008, 3), using their resource power to keep several members of the former Soviet Union unofficially intact. He identifies Russia's use of gas prices against Ukraine for political leverage, known as using the "tap weapon" (Nygren 2008, 5) as well as using pipelines that run through Russian territory to control the transit of Kazakh oil, known as the “transit weapon” (Nygren 2008, 9).

While these are the only two cases to be investigated further in their country profiles, Russia uses these weapons against several other post-Soviet states, including Turkmenistan, Georgia, Belarus, Moldova, and Uzbekistan. Except for the Baltics, almost every bordering state is affected by fuel trade with Russia, giving Putin’s regime the ability to alter their political and economic paths because their economy could not survive without it. As Ukraine and Kazakhstan are explored, the magnitude of this influence will become more evident in the democratic and economic transitions of these former Soviet states.

Economic Policy

Russia has taken a regressive approach to economic policy, using aggressive liberalization during the first decade under Boris Yeltsin, but moving back towards central control under Vladimir Putin. Yeltsin used what was commonly referred to as “shock therapy,” using radical methods to transition towards a market economy with little to cushion the backlash that would follow. Because of this harshness, Yeltsin became extremely unpopular, with his political career not lasting the time that it would take to show positive improvement.

Two months prior to the official collapse, Yeltsin along with his main economic advisor, Yegor Gaidar, began slashing budget spending on investment projects, defense, as well as producer and consumer subsidies. Upgraded tax collection agencies were created along with these budget cuts with the goal of reducing the deficit from 20% to 3% of GDP by 1993 (Cooper 1996). Immediately after the collapse, Russia made it a priority to free prices from government control, but, unlike Estonia, did it in a more radical manner. In a single step, price controls were lifted on 90% of consumer goods and 80% of intermediate goods, leaving Russian necessities such as bread, dairy products, sugar, and vodka. In order to promote trade, several restrictions were lifted and a fixed exchange rate was established for the ruble (Cooper 1996).

In order to compensate for the shift in prices, the government drastically increased the money supply so that it grew eighteen times by the end of 1992, exacerbating inflation and weakening the ruble (Cooper 1996). Also differing from Estonia, the Russian Central Bank (RCB) allowed domestic credit to increase nine times by the end of that year. At this point, the amount of inter-enterprise loans had reached 3.2 trillion rubles, resulting in the government providing 181 billion rubles to mitigate debt. This unrestrained policy resulted in the maintenance of the current deficit and an inflation rate of over 2,000% (Cooper 1996).

Because of these poor conditions, Yeltsin was forced to dismiss his economic advisor and prime minister, Yegor Gaidar, for the former head of the state's natural gas company Gazprom. Viktor Chernomyrdin, along with another chosen economic reformer, Boris Fedorov, decided to stabilize currency with strict monetary and fiscal policy that they referred to as the "anticrisis program." This included increasing interest rates by issuing government bonds, closing inefficient state enterprises, and creating quarterly targets for the budget deficit. This also included a safety net for the unemployed. However, further currency stabilization was compromised when the RCB refused to align with the prime minister, continuing to lend credit at subsidized rates under the pressure of agricultural and industrial lobbyists. This amalgamated into what is known as Black Friday, when the value of the ruble dropped by 27% on October 11, 1994 (Cooper 1996).

Yeltsin took control of the situation and his public image by firing the head of the RCB and replacing him with Tat'yana Paramonova, who put an end to cheap lending and raised interest rates. This time, parliament enacted policies to complement the RCB, restricting the use of monetary policy to finance state debt, and the Ministry of Finance issued bonds to help close the deficit. When the 1995 budget was drafted, anti-inflationary policy appeared to be its primary goal in an attempt to qualify for continued IMF loans. This policy was followed for the first half of 1995, but floundered as presidential and parliamentary elections came into political sights. Pressure mounted to pay state salaries that were delayed and increase spending in other ways that would please the constituency. As a result, Paramonova was forced out of her post at the RCB and replaced with her protégé (Cooper 1996).

Despite the arduous journey and constant switching of officials, Russia had made definite strides towards a market economy, freeing prices and handing over 70% of GDP to the private sector by 1997. However, the budget deficit remained high, which resulted in the financial crash of August, 1998. Half of Russian banks closed and the state was forced to default on its treasury bills (Aslund 2008). Although this became Yeltsin's swan song, it was also an important lesson of fiscal responsibility for the public and private sectors. After this incident, there was a consistent surplus for Vladimir Putin to enjoy.

When Putin was handed the presidency at the turn of the century, Russia was still in need of serious reform. Minimal property rights encouraged Russia's oligarchs to invest their fortunes abroad, causing situations of capital flight and making this state what P.L. Dash calls "economically anemic" (2001, 289). Russia's infrastructure was in disrepair and faulty tax collecting made the necessary funds unavailable, contributing to falling levels of output and deterring foreign direct investment. Several enterprises still used the barter system in order to pay their taxes or other debts, severely reducing liquidity (Dash 2001, 289).

Fortunately for Putin, he had the majority of parliament ready to support reform that had stalled under Yeltsin. Between 2000 and 2002, he was able to restructure tax collection, unifying the process into one agency, making the income tax progressive, and reducing corporate profit taxes from 35 to 24 percent (Aslund 2008). In 2002, Putin simplified registration and licensing procedures, opening the doors for small business creation. While Aslund (2008) believes that further deregulation is still necessary, the number of registered enterprises has been increasing by seven percent annually, reaching over 5 million enterprises in 2006. Also in 2002, the process to privatize agricultural land finally began, reversing a process that led to famine and rebellion during the rise of communism decades before.

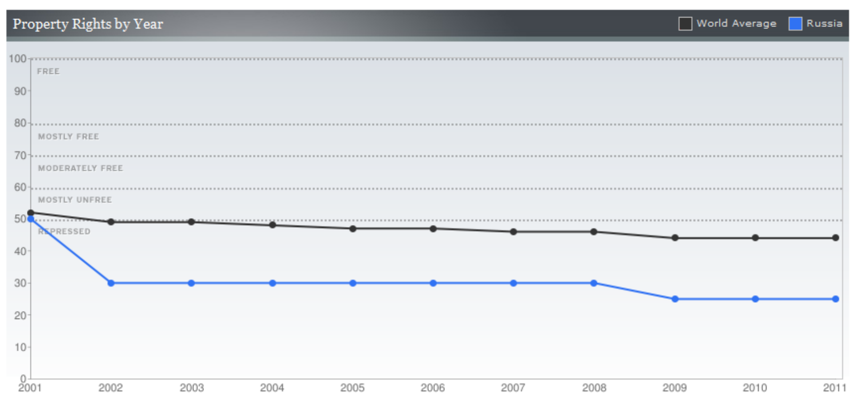
But in 2003, personal politics encouraged Putin to not only halt reform, but reverse it. The red flag, so to speak, was the confiscation of Yukos oil, which Aslund called "Russia's largest and most successful company" (2008). The owner of Yukos oil, Mikhail Khodorkovsky, was an outspoken business owner who devoted large amounts of time and money promoting democracy. Arrested at gunpoint and charged with tax evasion, Khodorkovsky was sentenced to nine years in prison in 2005, with new charges brought against him four years later (Khodorkovsky and Lebedev Communications Center 2011).

During the litigation process, Putin assured Yukos investors that the enterprise would not be nationalized, but he did not fulfill his promise. After this incident, state-owned enterprises began buying small private ones under rumors of bribery or coercion. This behavior has led to decreasing output in oil and energy production, banking, and machine building, although two-thirds of the economy is still privately owned. Aslund (2008) believes that these practices were able to take place due to rising international oil prices in 2004, which filled the state treasury. Budget surpluses existed until October 2007, until Putin began boosting public expenditures. In regards to reform, resources have allowed for complacency under Putin, leaving Russia in a comfortable enough state between reform and economic hardship.

Russian Freedoms

The new millennium opened with a Russian leader lacking interest in the free speech policies of Mikhail Gorbachev or the privatization policies of Boris Yeltsin. In regards to Putin's usage of coercion and kickbacks in order to take control of once private enterprises, Anders Aslund says that "the greatest calamity is that nobody is allowed to utter a word in protest" (2008). Rights and Liberties have noticeably declined since Yeltsin handed the presidency to Putin. According to Freedom House (2010), who gave Russia a ranking of 6 out of 7 for political rights and 5 out of 7 for civil liberties, Putin has slowly deteriorated Russia's freedoms through "electoral abuses, declining religious freedom, greater state controls over the presentation of history, growing police corruption," as well as using scare tactics against political opposition.

This year, the Heritage Foundation (2011) gave Russia an overall economic freedom score of 50.5, which falls nine points below the world average. The country ranks 143rd worldwide, falling beneath Laos, Syria, and the island nation Seychelles. This rank is attributed to declining freedom from corruption, investment freedom, and property rights scores, with each measure falling about twenty points below the world average. Over Putin's administration, property rights have declined despite his early reforms through 2002, which can be seen in Graph 1.6. Prior to 2000, the score hovered near the world average since the first score was given in 1995 under Yeltsin. This decline is due to a weak judicial system



Graph 1.6 Source: The Heritage Foundation 2011

which lacks sophistication and is also likely to lack the autonomy necessary to make uninfluenced decisions. The Heritage Foundation (2011) also cites “antipathy” towards contracts and their enforcement.

Not surprisingly, corruption is considered to be pervasive, despite President Medvedev’s Council for the Fight against Corruption established in 2008 or other anti-corruption legislation (Heritage Foundation 2011). In a 2010 poll, 23% of respondents said that they had bribed a service provider in the past twelve months (RIA Novosti 2010). These situations span from gaining employment or acceptance into a university, to avoiding military service or a prison sentence (Aslund 2008). Of course, this also includes business scenarios, with 71 percent of respondents in another survey reporting experiences with economic crime (Heritage Foundation 2011).

Reporters without Borders (2010) ranks Russia 140th out of 178 countries in their freedom of the press ranking, adding them to the eleven states under close watch for Internet censorship. Not only has Putin gained control of media through limited ownership and strong self censorship, but had also begun using tactics of intimidation on bloggers and other independent Internet reporters. Lipman and McFaul wrote in After Putin’s Russia, that “[Putin’s] campaign against privately owned national television was launched within days of his inauguration” (2010, 110).

While he did not seek direct ownership of newspapers, he possessed the ability to revoke subsidies, which kept major papers financially afloat (Lipman and McFaul 2010, 111). Television and radio are slightly different, which were consolidated under a newly created government agency, All-Russian State Radio and Television Company (VGTRK). Oligarch-owned networks ORT and NTV were not initially consolidated, but were instead stripped of their assets after their owners were sent into exile. Similar to Khodorkovsky, both were “disguised as business litigation” (Lipman and McFaul 2010, 114-115). Control over the media allows Putin to use it as a “one-way communication tube” with the Russian population, which has the capability to “shape the public perception of political reality and, in part, public affairs” (Lipman and McFaul 2010, 120). Therefore, Putin can create the illusion that reform is not necessary, and block the path to media outlets for those who still feel that it is.

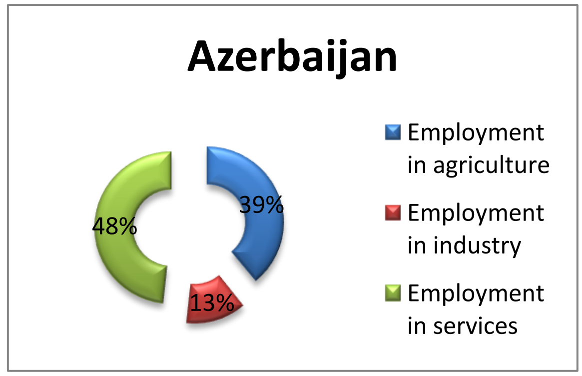
The Result

Since the takeover of Yukos in 2003, there have been no new economic reforms to speak of. Aslund (2008) attributed this to a lucrative oil market that gave Putin “license to be as authoritarian and corrupt as he really wanted to be.” Because of these practices, minimal growth has been seen in Russia’s GDP per capita since 1991, changing from $2,465 to roughly $2,644 per capita in constant 2000 US dollars. Life expectancy is estimated to be 67 years of age, nearly five less than Estonia. Infant mortality has declined from 23 to 14 deaths per every 1,000 live births, but this still pales in comparison to Estonia’s infant mortality rate of 5.3. Foreign direct investment is also lower at 3% of GDP, but this could be due to Russia’s size (World Bank Group 2011).

Although it appeared as though Russia was on a path towards democracy under Gorbachev and a stable market economy under Yeltsin, Putin was not able to leave the most lucrative of Yeltsin’s industries untouched. A perfect example of the corruption and economic policy effects, regaining control over Russia’s prime fuel-based enterprises took place as reforms halted, and, in this case, reversed.

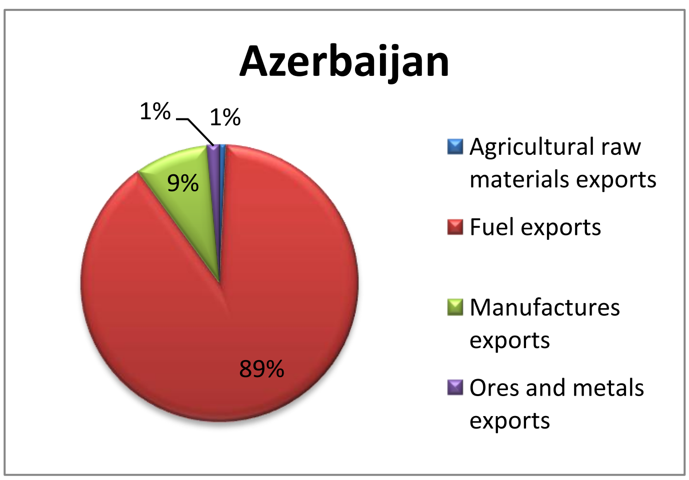
Azerbaijan

Azerbaijan, along with Georgia and Armenia, comprise what is known as the Caucasus. The largest of these smaller states in terms of size and density, Azerbaijan has a land area of 82,637 square kilometers and a population of 8.5 million as of 2006 (World Bank Group 2011). During this time, 6.8% of the labor force was unemployed, with 39% of the remainder employed in agriculture, almost half employed in services, and 12.7% employed in industry.



Graph 1.7 Source: World Bank Group, World Development Indicators

These numbers are not surprising considering the country's dependency on oil, which comprises a large portion of the trade exports that account for 66.5% of the state's GDP (World Bank Group 2011). Fortunately for Azerbaijan, its oil economy is mostly void of interference from Russia's "transit weapon" due to its geographic location mostly separated from Russian territory. Almost seven times the oil exports go to Italy than Russia, with France, Israel, and Turkey comprising the top four importers of Azeri oil (Encyclopedia of the Nations 2011). Therefore, this state's flawed transition towards a market economy would be due to its domestic supply, rather than its obligation to Russia.



Graph 1.8 Source: World Bank Group, World Development Indicators. All measurements are percentages of total merchandise exports.

Economic Policy

Azerbaijan, a country less willing to separate from the Soviet Union, took longer than the Baltic states to create new economic policy to separate itself from its Soviet past. Attempts to privatize and free prices did not occur until about 1995, when President Heydar Aliyev felt that there was enough political stability to undertake such changes (Kamrava 2001, 224). Under the guidance of the World Bank, the government sought to reduce inflation from 29% to 2% by the end of 1995, increase privatization through a voucher system, enforce financial discipline, and revamp the tax system (Kamrava 2001, 225).

Despite Aliyev's ambitious intentions, the period between 1995 and 1996 was characterized by frustration due to lack of experience. Reforms were not implemented as President Aliyev and the World Bank had hoped due to a lack of management skills from Azeri ministers and the absence of bureaucratic mechanisms to put reforms into action (Kamrava 2001, 225). However, these inadequacies were ignored because of the wide-spread belief that oil revenue would transform Azerbaijan into an economic powerhouse (Kamrava 2001, 26). This attitude prevents revenue from spreading to other industries, which would diversify the Azeri economy for the sake of its long term health. Several of these industries are labor intensive, meaning that even a limited spread of capital from the oil industry would have a positive impact on productivity (Laurila and Singh 2001, 55).

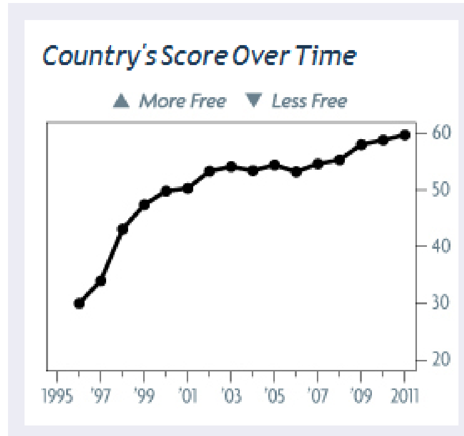
While this state has reaped some rewards from its economic "trump card," it has not developed its financial institutions enough to handle influxes in revenue (Kamrava 2001, 226). Laurila and Singh (2001, 55) refer to the underdeveloped banking sectors as the "Achilles' heel" of the economy. Without the most basic services available, such as transfer of payments, oil revenues tend to end up in foreign banks. Also, several private sector banks cannot meet the minimum capital requirement, meaning that many will need to close (Laurila and Singh 2001, 57). This also pushes businesses to use the barter system rather than banks, which accounted for 50 percent of GDP in 2001 (Laurila and Singh 2001, 58).

Privatization of large and medium-sized firms is considered to be unsuccessful, with the government refusing to give up its most valued enterprises, such as oil and telecommunications. The privatization that has occurred is often riddled with self-seeking behaviors from those within the country's financial-political elite. A list of enterprises to be privatized was never created, allowing the government to privatize on a case-by-case basis in an "under the counter" fashion (Laurila and Singh 2001, 61). This would not allow for a reputable voucher system, making only the less desirable businesses available for ownership.

Azeri Freedoms

Azerbaijan has poor freedom ratings on most counts. Considered "Not Free" by Freedom House (2010), the country received a poor political rights rating of 6 out of 7 and a civil liberties score of 5 out of 7. This is largely due to the limitation of political parties and the 2009 policy eradicating presidential term limits for the former President's son, Ilham. Political competition is severely limited in parliament, allowing the President's Yeni Azerbaijan Party to maintain the majority. Also, Presidential elections have been considered fraudulent, making elections neither free nor fair. This state also limits freedom of assembly, especially for opposition parties, who are sometimes subject to arrest and torture by police. NGOs must file paperwork with the state before opening offices, although they remain more open to organizations than Russia (Freedom House 2010).

Azerbaijan ranks 92nd worldwide in terms of economic freedom according to Heritage Foundation (2011), with the basic components of property rights and freedom from corruption severely lacking. Although the overall score has increased because of financial and fiscal stability, other necessary components of a growing economy are not present. Azerbaijan was given a property rights score of 20.0, ten points lower than it was in 2001. It is widely agreed upon that the judicial system lacks quality, reliability, and transparency, as well as contract enforcement (Heritage Foundation 2011).



Graph 1.9 Source: The Heritage Foundation

Although the freedom from corruption score has improved, it is far below the world average at 23.0 (Heritage Foundation 2011). The judiciary has inadequate separation from the executive branch, with all judges below the Supreme Court level appointed by the president with no parliamentary confirmation. Laurila and Singh (2001, 52) also suspect that most government positions are purchased. The Heritage Foundation (2011) calls corruption "rampant," occurring at all levels, including arbitrary tax and customs enforcement and preferential business practices.

Reporters without Borders (2010) ranked Azerbaijan 152nd out of 178 states, reflecting intimidation of journalists and restrictions on foreign media. Following Aliyev's re-election in 2009, Radio Free Europe, BBC, and Voice of America were no longer available. Domestically, Agil Khalil was forced to flee the country in 2008 after reporting on state corruption and escaping an attempted murder. Any reporter investigating crime or corruption may face police intimidation or abuse, assaults, or sham trials. Discussing unemployment has also become taboo, landing several journalists in prison (Reporters without Borders USA 2010).

The Result

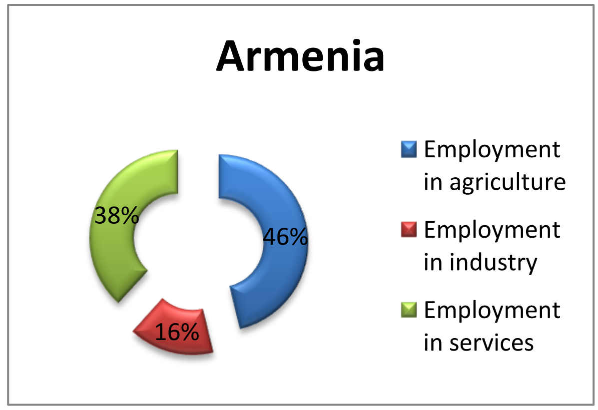
Due to limited property rights, an unstable banking system, and a reliance on fuel exports for GDP, Azeri citizens currently experience a low standard of living and a nonresponsive government. Like Russia, there has been some GDP growth, but nothing substantial. Azerbaijan began as a free state with GDP per capita of 1,222 constant 2000 US dollars, and grew to $1,573 in 1996. Life expectancy is slightly higher than Russia's at 69 years, but infant mortality is the highest out of all six countries to be examined. The rate was 74.9 deaths per live births in 1995, and although it has nearly halved to 37.1, this is still a high number. Foreign direct investment was practically nonexistent in 1996 (World Bank Group 2011).

Azerbaijan followed almost none of the advice of the economists from the *Journal of Economic Perspectives*, but offers of perfect demonstration of how resource wealth can make a government complacent in terms of reform. However, the tides may change over the coming decade due to speculations that the country's oil may run out in the next 20-40 years (Open Net Initiative 2010). This could force a corrupt government to focus more on technological development, which may involve allowing the private sector to take on this task. The lack of exportable fuel could be the turning point for this post-Soviet transition.

Armenia

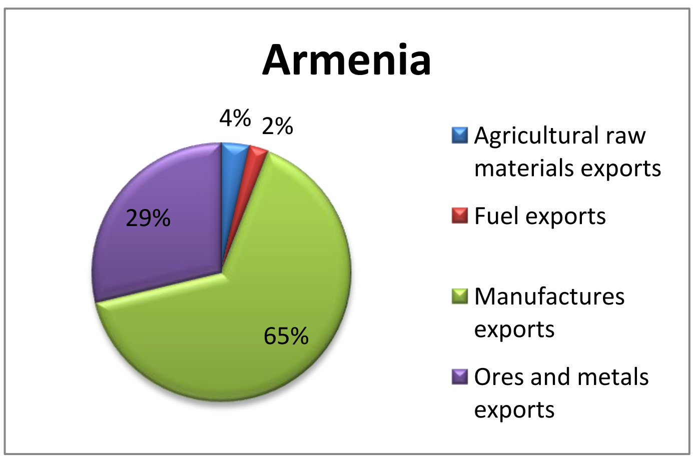
The second state to be discussed in the Caucasus region, Armenia, is similar in size, but different from Azerbaijan in several respects. With a land area of 28,000 square kilometers and a population of about 3 million, Armenia's economy has a heavy focus on agriculture, rather than fuel (World Bank Group 2011).

Almost half of Armenia's labor force is employed in the agricultural sector, with far less employed in industry as of 2006. This shows that the Armenia's economy has chosen to emphasize the agriculture that existed throughout the Soviet era and focus less on updating the inefficient machinery left behind from the same period. The top crops are vegetables, melons, wheat, and grapes, according the Encyclopedia of Nations (2011).



Graph 1.10 Source: World Bank Group, World Development Indicators

The focus on agriculture is less evident when looking at Armenia's exports, which account for about 23% of the country's GDP (World Bank Group 2011). This may be due to the World Bank's categories used in our analysis, which looks at the level of agricultural raw material exports, rather than its processed foods or it could be that the state's agriculture is used domestically. Regardless, this graph still demonstrates Armenia's low reliance on natural resource exports.



Graph 1.11 Source: World Bank Group, World Development Indicators. All measurements are percentages of total merchandise exports.

Economic Policy

When Gorbachev implemented his liberalization policies, Armenia made an honest attempt to privatize its service and agricultural sectors. According to the Library of Congress, arable land makes up about 16% of Armenia's total area, making agriculture an important part of the state's economy. Armenia was the first state to privatize land, passing legislation as early as 1990. Although the rapidity of the process created some problems due to its disorganization, assets were able to be distributed to Armenian citizens, including the peasant class. By 1992, "63 percent of cultivated fields, 80 percent of orchards, and 91 percent of vineyards" fell into private hands of all sorts. Although food processing and other facilities remained state owned at this time, agricultural output was able to increase 15% between 1990 and 1991, a time when growth across the USSR was scarce (Curtis and Suny 1994).

However, the Armenian mafia and other corrupt individuals stifled this effort in other sectors, unwilling to sacrifice its positions of privilege within the command economy. In 1991, the opportunity to democratically elect a new government allowed for institutionally structured reform. Despite the remaining corruption and conflict with Azerbaijan over the Nagorno-Karabakh region, the Law on the Program of Privatization and Decentralization of Incompletely Constructed Facilities was passed in 1992, creating a politically diverse privatization committee. The next year, a two-year program was implemented that would privatize 30% of state enterprises in its first stage and the remaining 70% at a later time. It was structured this way in order to sell off services and lighter industries first, and then shift to the larger, riskier investments. Under this system, 20% of a firm's assets would go to its workers, 30% would be distributed to citizens in the form of vouchers, and 50% would be distributed by the government (Curtis and Suny 1994).

Financial reform was a much slower process due to debts from the Nagorno-Karabakh conflict. Maintaining the ruble, a budget deficit grew rapidly due to national defense spending and attempts to mitigate the pains of price liberalization. Despite its economic growth in the agricultural sector and its commitment to quick privatization, Armenia faltered in its ability to provide stable credit via banking reform. Until 1994, the State Bank of Armenia, as well as its Bank of Foreign Economic Affairs remained branches of the central banks in Moscow, which took away even the capability of monetary control until this time. Even when Armenian banks became separate from Russia, they were not granted separation from government control. As a result, stabilization of Armenia's new currency, the dram, would come after more populist policies (Curtis and Suny 1994).

Because of the need for national defense, taxation became essential, but would become a point of contention for several years to come. The 1992 budget included several new taxes, including a 25% tax on hard-currency export earnings, a value-added tax, excise taxes, and a new system of enterprise and personal income taxes. Besides military funding, this revenue was also budgeted for subsidies and other price liberalization painkillers. The process of lifting government control of prices occurred in three stages: improving agriculture and raising government prices on certain staple goods, raising wholesale prices and tariffs closer to world market levels, and finally releasing prices for all goods except for food, medicine, utilities, and transportation. As a result, inflation peaked at nearly 1,200 percent, but fell to below 17% by the summer of 1993 (Curtis and Suny 1994).

Although specific policy information is difficult to find after this period, a World Bank country study assessed the economic situation in Armenia between 1994 and 2002, along with its challenges to growth. This text describes that early policy decisions are deterring growth, including the rapid and somewhat unorganized privatization process, national defense spending against Azerbaijan and the border blockades that followed, as well as overall weakness of public institutions (The World Bank 2002, 67). As of 2002, two-thirds of Armenia's borders were closed as a result of the conflict, and the remaining border through Georgia does not provide for efficient transportation (World Bank 2002, 87).

Between 1995-99, grants and low-interest credits from foreign donors made up roughly 7% of Armenia's GDP (World Bank Group 2002, 1). This has also hindered the reform process, because donors have been less insistent on how grants and loans are used (The World Bank 2002, 8). Rather than build institutions that would promote small business creation, Armenia is relying on oil revenue and foreign donations. The World Bank (2002, 72) cites that several constraints to new businesses and foreign investment exist, including taxes and regulations, policy instability, the exchange rate, inflation, and financing.

Armenian Freedoms

Despite its lack of natural resources, Armenia is considered to "Partly Free" by Freedom House (2010), receiving a low political rights score of 6 and a higher civil liberties score of 4. This is dues largely to political corruption, which it has cited in every major election over the past decade. After rioting broke out over election results in 2008, restrictions were imposed on freedom of assembly and almost no action has been taken against police officers who committed unlawful brutality against protestors. Officers are known to make arbitrary arrests and use violence against detainees, sometimes resorting to torture (Freedom House 2010).

Armenia ranks 36th worldwide in the Heritage Foundation's (2011) ranking of economic freedom, which is surprisingly high. Falling just below South Korea, Armenia received scores above seventy in almost every category. However, its two lowest scores are in property rights and freedom from corruption, the two most focused upon scores in our analysis. Armenia received a property rights score of 30 and a freedom from corruption score of 27.0, falling 2 points from the previous year. The Foundation states that bribes given to government officials have become routine, and that prominent business owners are often given monopoly privilege in certain industries (The Heritage Foundation 2011). According to Freedom House (2010), the judicial system is extremely weak, giving in to the corruption of the executive branch. This has contributed to a lack of faith in contract enforcement, deterring potential property owners and entrepreneurs.

Armenia ranks 101st out of 178 countries for press freedom, which is almost forty places higher than Russia, despite its barriers to a free press. Freedom House (2010) reported that owners of most media outlets are in cahoots with the Armenian government and that Armenian Public Television is state-run. Although it is not explicitly against the law, outlets covering political opposition are sometimes harassed, and criticism of the government is considered to be libel. The Internet has not been targeted at this point, but that could be due to Armenia's limited technological growth.

The Result

Because of war and other factors, Armenia has not been able to make a commitment to reform. Although it made early attempts to privatize, a lack of fiscal discipline and the large amounts of taxes and regulations making transitioning out of the agricultural sector extremely difficult. The closing of Armenia's borders that resulted from the land dispute with Azerbaijan further complicated this process by hindering the state's ability to trade.

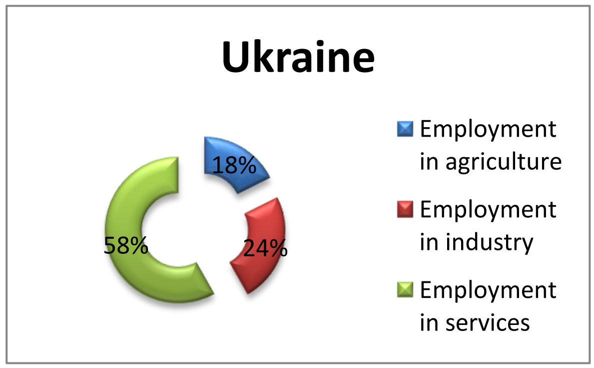
Because of Armenia's inability to create a stable business environment, it has seen little growth, despite its lack of natural resources. Although this state had the lowest level of per capita GDP to begin with at 708 constant 2000 US dollars, it only grew to $1,255. The life expectancy is slightly higher than Estonia at 73 years, but infant mortality does not follow this trend. However, an improvement still occurred, falling from 42 deaths per 1,000 live births in

1995 to 23 in 2006. Despite the legal barriers described in the World Bank report, Armenia still attracts foreign direct investment, which accounted for about 7% of GDP in 2006 (World Bank Group 2011).

Ukraine

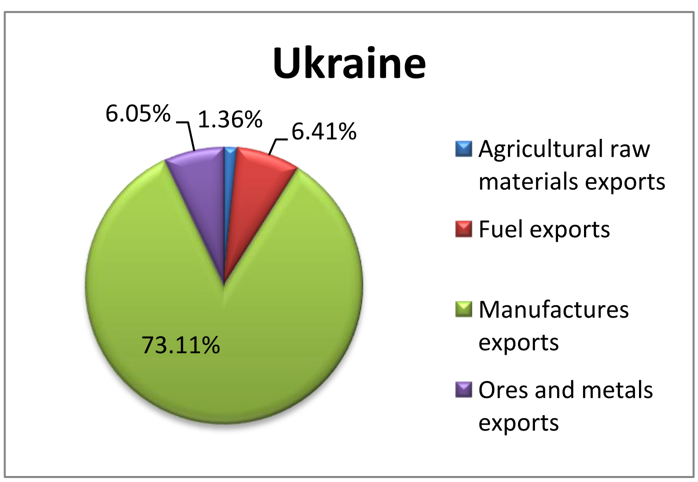
Ukraine, along with Belarus and Moldova, form the politically diverse states of the European Former Soviet Union. This state, the largest in this region, has an approximate land area of 580,000 square kilometers and a population of over 46 million as of 2006 (World Bank Group, 2011).

Looking at Ukraine's labor force composition, there is an expected level of service sector employment, but an agricultural focus that is slightly larger in comparison to Estonia and smaller in comparison to Azerbaijan. There is some evidence of industry, providing almost a quarter of jobs in Ukraine.



Graph 1.12 Source: World Bank Group, World Development Indicators

Exports of goods and services account for roughly 46.6% of Ukraine's GDP, showing the importance of trade in this country's economy (World Bank Group 2011).



Graph 1.13 Source: World Bank Group, World Development Indicators. All measurements are percentages of total merchandise exports.

Ukraine has a low reliance on natural resources, gaining most economic revenue from manufacturing. While

Ukraine does export some metals, its largest exports include semi-manufactured petroleum products that have been imported, food products, as well as machinery and transport equipment (Encyclopedia of the Nations 2011). This area does possess coal, oil, and natural gas, but whatever is extracted fills less than a quarter of Ukraine's demand, according to Encyclopedia of the Nations (2011).

Because of their lack of resource endowments, Ukraine has relied on Russia for gas imports. This has allowed Russia to use the "tap weapon" as leverage against Ukraine, by threatening to charge world market prices after years of providing gas at a lesser cost. Nygren believes that this weapon was employed as a way to discourage Ukraine's 2004 Orange Revolution because a move towards democracy would be a move against Russia. TO send a strong message, Gazprom announced that it would begin to implement market prices, raising the current price from $50 to $160 per thousand cubic meters of gas beginning in January 2006. However, Ukraine was able to defend itself because Russia's major pipeline to Germany ran through Ukrainian territory, giving it the opportunity to siphon off traveling gas. The result was a price increase for both parties, with Ukraine subjected to an increase of $45 per thousand cubic meters and a 50% increase in transit rates paid by Russia (Nygren 2008, 6).

Russia's potential to unleash the "tap weapon" may make any politician hesitant to promote democratic reform. As we will see, Ukraine's political actors have a tendency to place their political careers over necessary reform, making this weapon an even larger deterrent of democratic and economic reform.

Economic Policy

Several factors hindered Ukraine's economic stability as a young, newly independent state. According to an article by Victor Pynzenyk (1994, 198), who served as this state's

Minister of Economy, the USSR invested less on Ukrainian infrastructure in comparison to other states, making the development of industry more difficult. Many of its current industries were inefficient in terms of energy, making them operable only under Soviet energy subsidies. When the cost of oil rose from $42 per ton in 1992 to $73 in 1993, this state had little to fall back on after gaining independence. Dr. Kravchuck (1997) of Harvard University went so far as to say that Ukraine could be described as an "economic basket case," with record- setting declines in output, employment, productivity, and investment (Kravchuk 1997).

While Ukraine made an attempt at strict economic reform immediately after the formation of its new government, it was drastically reversed in order to compensate for the economic hardship that followed. Initially, the National Bank of Ukraine enforced a strict budget and targeted inflation, raising the discount rate to 240% (Pynzenyk 1994, 198). This policy was successful, with inflation falling from 79% in January to 19% by March. Even with a strict budget and extreme inflation targets, Ukraine still provided a safety net for children, the disabled, and pensioners, who comprised a large part of the population. Also, the state began to privatize, focusing on large and medium-sized enterprises, bringing the country towards a market economy (Pynzenyk 1994, 199).

Handling the hardship of drastic economic change, Ukraine began to lose its financial discipline, putting large amounts of money into agricultural subsidies, increasing the minimum wage and pensions, as well as tax exemptions (Pynzenyk 1994, 199). This occurred largely because the National Bank of Ukraine did not possess autonomy in order to maintain fiscal control, making its decisions based on the will of parliament (Kravchuk 1994). To alleviate stress, it began lending out credit to the agricultural sector so far below the discount rate that the money supply was growing by 50% monthly in the summer of 1993. Into the winter months, interest rates for agricultural enterprises were as low as 28%, while the national discount rate remained at 240%.

In order to deal with the shortage of government revenue, prices remained under state control so that the state could gain additional tax revenue by raising prices. This was the primary method of balancing its massive subsidies, which was not only fiscally unsustainable, but aggravating to the public (Pynzenyk 1994, 200). Along with Ukraine's refusal to free prices, the state also decided to create a fixed currency exchange rate in August 1993 that was largely overvalued. This damaged Ukrainian exports and caused massive capital flight from its borders (Pynzenyk 1994, 200). As a result, Ukraine experienced what Dr. Kravchuk (1997) believes to be the worst case of inflation out of all post-Soviet states, rising at a monthly average of 33% from 1992 to 1994. Ukraine had seven instances of hyperinflation during this time period, with six monthly price increases of 50% or more occurring in the second half of 1993 and one occurring in 1994.

After exhausting the money supply, Ukraine was forced to make currency changes in 1996 after adopting a new constitution. On August 24, Ukraine's second president, Leonid Kuchma, announced the hyrvnia as the state's permanent currency. This eliminated the temporary karbovantsi that had become so cumbersome due to numerous months of inflation, so much so that the change cut five digits off of all shop prices (Kravchuk 1997). The hyrvnia was exchanged at 1.76 per U.S. dollar, which rose to 1.88 by December, but remained relatively stable.

However, this change was not followed by continued reform, resulting in an incomplete Ukrainian transition. Attempts at reform were still made by Deputy Minister for the Economy Viktor Pynzenyk, but lacked the support needed to gain adoption. The program, developed by

Pynzenyk and a large group of experts, addressed issues of unnecessary public expenditures, high tax rates, the enforcement of bankruptcy, and unjustified tax exemptions (Aslund and Menil 2000, 10). Ukraine's top politicians did little to support this program, leading to its failure and Pynzenyk's resignation in March of 1997. The IMF attempted to incorporate this failed attempt into a three-year loan program, but Ukraine refused to comply, resulting in the denial of funds from the IMF, as well as the World Bank (Aslund and Menil 2000, 11, 12).

Not only did reform stall after this failure, but previous reforms were reversed. Regulations over agricultural trades were reinstated, bartering was allowed to proliferate, bureaucratic control over state enterprises increased, and foreign trade regulations became more complex (Aslund and Menil 2000, 11). Complacency continued in the summer of 1997 due to the booming Russian stock market, which created a similar boom in Ukraine's. That year, the budget deficit rose to double of what was recommend by the IMF, and GDP fell by three percent (Aslund and Menil 2000, 12).

It took a revolution in 2004 to put the economy back on a path of liberalization, although the process sometimes involved personal politics. The Orange Revolution changed political dynamics, allowing Ukraine to align itself more with its European neighbors. Although it had a slow and unorganized beginning, customs tariffs were reduced to encourage trade, loopholes regarding tax collection were abolished, and unfair exemptions were eliminated. As a result of these changes, the budget deficit was halved to 2.3 percent of GDP between 2004 and 2005 (Aslund 2009, 205). Reprivatization was the administration's largest priority, but did not occur with neutrality. When privatizing the enterprises of her foes, Prime Minister Tymoshenko apparently "took pleasure" in the process of placing assets in the hands of private competitors (Aslund 2009, 206).

Aside from personal vendettas, Tymoshenko maintained support for some socialist practices, such as price controls over oil and meat, as well as state control over some of Ukraine's largest enterprises. This was due to more populist policies that required large amounts of revenue from these enterprises that would fund price-controlled commodities (Aslund 2009, 207). As a result of arguing over privatization, issues of property rights were ignored. This, coupled with the increased tax burden, resulted in decreasing GDP growth that eventually became negative.

After being asked to resign, Tymoshenko changed her stance, allowing prices to painfully rise and composing a program to privatize 19 large companies. However, it was President Yushchenko who believed that privatizing certain enterprises would be a security risk, halting auctions (Aslund 2009, 223). Although Ukraine has made improvements, political conflict between former revolutionary allies distracted its top leaders. Although Ukraine is considered to have a market economy, the slow speed at which it came about has had severe social consequences.

Ukrainian Freedoms

Despite its flaws, Ukraine is considered "Free" by Freedom House (2010), making it the only free post-Soviet states outside of the Baltics, receiving a 3 for political rights and 2 for civil liberties. Following the Orange Revolution of 2004, elections have been considered free and fair, although this does not necessitate a stable regime. While recent constitutional reforms have shifted some powers from the president to the parliament, Freedom House (2010) believes that the parties comprising it lack strong ideologies and political platforms, making them more of a vehicle for whoever backs the party financially.

Economically, the Heritage Foundation (2011) gives Ukraine an overall score of 45.8, over ten points below the world average. It is ranked 164th worldwide, falling below the highly authoritarian state of Uzbekistan. Ukraine received a property rights score of 33 due to a lack of improvement in the judiciary's enforcement of property rights, a branch of the government that is largely under the control of the president. The country's freedom of corruption score is worse, dropping three points to 22, far below the world average of 40.5 (Heritage Foundation 2011). The Foundation believes that this is sparked by low salaries for public employees, spreading corruption throughout the highway police force, tax administrators, and those involved in the public education system. Freedom House (2010) adds that the nature of political parties and the wealthy party bosses who control them also contributes to this issue.

Ukraine's press freedom is low compared to Estonia and Armenia, which is surprising given its free status. It ranks 131st worldwide out of 178 states and its score has been on the decline (Reporters without Borders 2010). Unlike Kazakhstan, Ukraine has a less-cooperative relationship with Russia, which can materialize in mass media relations. Ukraine has attempted to block Russian media, banning Russia's most influential networks in November 2008. Russian news and film sometimes accuses Ukraine of hosting secret CIA prisons and claims that Ukrainian soldiers fought with Georgia against Russia in the battle for South Ossetia the same year (Freedom House 2010).

The Result

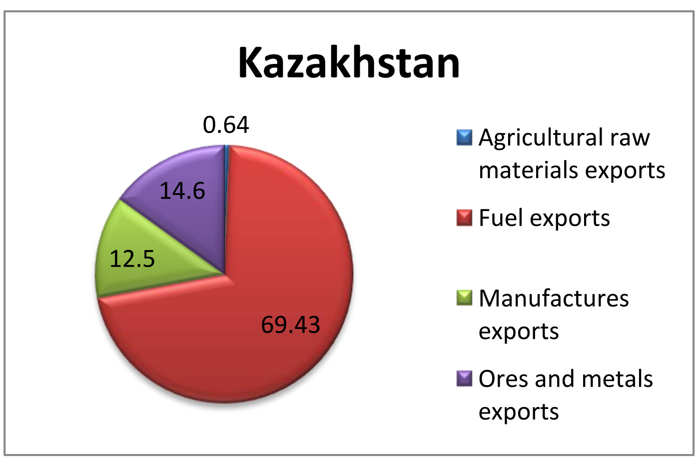
Given Ukraine's stop-and-go reform process, tendency to heavily subsidize, and political squabbles referred to in the Murrell article, Ukraine's status as a free state is not reflected in its economic growth. The lack of fiscal discipline and solid reform could be due, in part, to the "tap weapon," which ties Ukraine to its Soviet past through fuel import prices.

Ukraine is the only state in our analysis that has a lower GDP per capita in 2006 than it did in 1991, producing a decline from $1,267 to 1,037 constant 2000 US dollars. Life expectancy was estimated at 68 years and infant mortality dropped slightly from 17.9 deaths per 1,000 births in 1995 to 14 in 2006. Foreign direct investment accounts for 5% of GDP, which is lower in comparison to the other five states (World Bank Group 2011).

Kazakhstan

A member of the oil-rich countries known as Central Asia, Kazakhstan holds an interesting international position due to its large shared border with Russia. It is also an opportune area to study due to the lack of data for Uzbekistan and Turkmenistan, the most authoritarian states of the Former Soviet Union. Kazakhstan, the largest of these states, has a land area of about 2.7 million square kilometers, and population of roughly 15.3 million as of 2006 (World Bank Group 2011). The composition of the labor force and the unemployment rate are missing for this country, but exports account for 50% of GDP (World Bank Group 2011).

Kazakhstan is an area rich in oil and several valuable minerals. Soviet geologists once bragged that this area was capable of exporting the entire periodic table, providing iron ore, manganese, coal, uranium, chrome, titanium, nickel, wolfram, silver, molybdenum, bauxite, and copper (Olcott 1996). It also lists the state's top industries as mining these minerals, as well as chemical refining, machinery, and oil (Olcott 1996). Falling between Russia and Azerbaijan, natural resources comprise a large proportion of Kazakhstan's merchandise exports, with



Graph 1.14 Source: World Bank Group, World Development Indicators 2006. All measurements are percentages of total merchandise

almost 85% made up of fuel and ores and metal exports in 2006 (World Bank Group 2011). Manufactures account for an amount of exports almost as minimal as Azerbaijan, demonstrating a heavy reliance on its natural resources.

Kazakhstan's resource richness has become a democratic liability due to its Russian border, falling victim to Russia's "transit weapon." Because Soviet-era pipelines are still owned by Russia's Gazprom, states that have not been able to fund additional pipelines or cannot reach agreements to do so with neighboring states are at Russia's mercy. Because of this ownership, Russia can manipulate the sale of Kazakh oil in two ways: buying oil at a lower price and transporting it to Europe at a higher price, or buying low in order to satisfy its own demand and export its own reserves. Because Russia wants to maintain attractive prices to use the "tap weapon" against other states, Kazakh enterprises are paid much lower than world prices (Nygren 2008, 8).

Because of this situation, Kazakhstan has maintained a positive relationship with Russia, refusing to risk the loss of business. The state even invited Gazprom to take control of its gas distribution network (Nygren 2008, 9). In response to Central Asia's proposed pipeline projects, Putin attempted to establish a cartel with Kazakhstan along with Uzbekistan and Turkmenistan (Nygren 2008, 8). Because of geography and Soviet infrastructure, Kazakhstan must constantly comply with Russia in order to maintain its economy. Even though the state could sell for a much higher price bypassing Russia, the revenue that would be lost while constructing pipelines may be too damaging in the short term.

Economic Policy

In terms of infrastructure, Kazakhstan was given a head start within the USSR. Cultivation and irrigation were funded by the Union's "Virgin Lands" program, along with investment in industry in order to harness the area's vast fuel and mineral resources (Encyclopedia of the Nations 2011). However, roads and energy-related sources were purposefully concentrated in areas connecting outside of Kazakhstan, rather than creating an infrastructure within the republic.

Kazakhstan remained within the "ruble zone" during the first years of independence, but the zone disbanded in 1993 due to the previously discussed lack of financial and monetary discipline in Russia. As a result, the Kazakh tenge was created that same year (Kasera and Katz 2007, 4). Initially, the new currency was pegged to the US Dollar, but due to pressure from the United States and other Western nations, it became free floating. The tenge depreciated following this decision, allowing it to stabilize by 1995 (Kasera and Katz 2007, 4). Because of this decision, Kazakhstan managed to emerge as an attractive exporter after suffering only a short recession.

This success is largely attributed to the discipline and control of the National Bank of Kazakhstan, or NBK (Kasera and Katz 2007, 5). It was given free control to conduct monetary policy, which targeted inflation and quickly stopped financing state debt. Because of this, Kazakhstan began to issue securities, giving the NBK tight control over the money supply. The National Bank also played a large part in fighting economic corruption, combating the ponzi schemes and public looting that often took place within the country's nearly 200 commercial banks. It raised banking and capital requirements and withdrew licenses, lowering the number of banks to 48 by 2001 (Kasera and Katz 2007, 11). However, Kasera and Katz (2007, 5) believe that the National Bank may have been too tight with the money supply, which eventually put a strain on small businesses, making Kazakh goods less attractive internationally.

Initially, the government maintained ownership of the state's larger enterprises, including energy and telecommunications. Agglomerations were created in order to help the state restructure certain industries and attempt to reverse output declines, but with little success (Peck 2002, 33). Similar to Russia, Kazakh-owned businesses had no way of collecting payments and, thus, paying wages. This resulted in the division and privatization of these clustered enterprises, mostly between October 1994 and September 1997. Foreign investors took control of this opportunity, seizing ownership through management contracts, joint ventures, or complete purchases (Peck 2002, 33). This was allowed with the encouragement of Prime Minister Akezhan Kazhegeldin and the blessing of President Nazerbayev, showing Kazakhstan's openness to foreign investment.

However, support from the president dwindled, forcing the prime minister to flee the country. As a result, these contracts were cancelled and enterprises were resold, mostly to those who had already made purchases, severely concentrating the number of buyers (Peck 2002, 34). It has become increasingly suspected that bribery and other forms of illegal negotiations took place during this time due to the opaque nature of negotiations (Peck 2002, 54). Although this increased the speed of sales, it hurt the competitiveness of Kazakhstan's economy, allowing the most lucrative industries to cluster into massive, Soviet-style enterprises. Just as economic power fell into a limited number of hands in Russia, Kazakhstan's major businesses came under the tight control of an elite circle. The Kazakh government's financial industrial groups also claimed ownership of some of the state's resources, stunting Kazakhstan's growth into a market economy.

The financial crisis that hit Russia in 1998 threatened the recent stability of Kazakhstan's currency. The state spent over a billion dollars protecting the tenge from inflation, halving the country's foreign reserves. Fortunately, these efforts were successful and the National Bank maintained its previous discipline. Because of cheap goods flowing in from Russia, Uzbekistan, and Kyrgyzstan, temporary import restrictions were put into place in order to protect domestic industries. Import duties reached 200% in some cases and the amount of currency that could be taken out of the country was reduced from $10,000 to $3,000 (Kasera and Katz 2007, 6). Despite these measures, growth became negative for the first time since 1995, but Kasera and Katz (2007, 7) believe that the measures taken mitigated what could have occurred.

In April of 1999, the NBK decided that pegging the tenge was no longer the currency's best option, making it free floating. As was expected, its value dropped by 40%, which would help to make domestic goods more competitive internationally (Kasera and Katz 2007, 7). The ability to cause inflation demonstrated Kazakhstan's stability as a state, showing that its citizens would be willing to bear uncomfortable economic change without causing a change in regime. This also occurred due to measures taken by the National Bank to increase confidence, which included poverty reduction, directing foreign exchange earnings to the market, rather than to the government, decreased banking regulations, and forward currency contracts that would make bank accounts more attractive, rather than withdrawal (Kasera and Katz 2007, 8).

Kazakh Freedoms

Despite the National Bank's good intentions, Kazakhstan demonstrates low levels of freedom across the board. Freedom House (2010) claims that conditions are worsening, giving them a 6 out of 7 for political rights and 5 out of 7 for civil liberties. The same political party has maintained leadership since 1991 under Nursultan Nazarbayev, who has successfully altered term limits and the style of government in order to hold onto power. Laws have been put into place that prevent opposition parties from gaining seats that would jeopardize Nazarbayev, giving him considerable power over the legislature. Parties based on gender, ethnic origin, or religion are prohibited and those that do not fall under these categories must have at least 50,000 members in order to register, a number that was raised drastically from 3,000 in 2002 (Freedom House 2010). Freedom of assembly involving political opposition is severely restricted and any sort of publication speaking against Nazarbayev is quickly banned, especially within the educational system (Freedom House 2010).

Although Kazakhstan's economic freedom is higher than the world average, it is still much lower than 84.1, the average for free economies. Steadily increasing to a score of 62.1, Kazakhstan ranks 78th worldwide, which is the result of high business freedom, but the country has below-average property rights and freedom from corruption (Heritage Foundation 2011). Freedom House (2010) reports that although these rights are formally protected, the attainment of property is extremely difficult due to bureaucratic hurdles designed to keep wealth concentrated in a few hands. This shows a continuation of the practices that took place during the privatization period, where those close to the government were given the upper hand in controlling Kazakh wealth.

Today, these practices are continued in the form of corruption, which has been called pervasive by the Heritage Foundation (2011). This is partly due to occurrences of law enforcement pressuring foreign investors to cooperate with the Kazakh government's interests, but this practice may be on the decline due to anti-corruption legislation signed in 2009. This new law aims to expand the definition of corruption and increase punishment, raising the state's freedom of corruption score up five points (Heritage Foundation 2011). However, because the judiciary is so closely tied to Nazarbayev, the success of this legislation is questionable.

Although Kazakhstan has shown a consistent effort in improving business freedom, this is stunted by the state's poor freedom of the press, which has been following the opposite trend. Out of all six states in our analysis, Kazakhstan falls furthest on the Reporters without Borders (2010) ranking, holding the 162nd place out of 178 countries. In order to encourage self-censorship, massive fines have been placed on media outlines under charges of "insult" and "defamation." International sources such as Radio Free Europe have also been restricted (Reporters without Borders USA 2010).

The separation between granting economic rights and other rights and liberties is shown in the shortcomings of Kazakhstan's newest attempts to modernize. The "Development Strategy of Kazakhstan until 2030" is a government initiative that seeks to liberalize the telecommunications industry, with the goal of achieving infrastructure similar to more developed countries (Open Net Initiative 2010). However, this initiative does not include goals involving Internet freedom, which is shown by the roughly 300 legislative acts that explicitly or implicitly allow for some form of control. Under this control, all Internet service providers are required to connect their channels to a public network under Kazakhtelecom, an information technology monopoly that was created by the government in 1999. Demonstrating close economic ties with Russia, Kazakhtelecom and major Russian telecoms have signed an agreement to provide filtering, censorship, and surveillance based on the Security Council resolutions of each respective state (Open Net Initiative 2010).

The Result

Kazakhstan followed a different route than Russia's "shock therapy," which resulted in overall success in weathering potential crisis. Kasera and Katz (2007, 9) believe that this is largely due to a more stable political environment, which encouraged entrepreneurship and investment. However, Kazakhstan mirrors Russia in the sense that although in encourages small business growth, the largest, most lucrative industries remain under state control. It is also important to note that Kazakhstan chose to privatize because it could no longer afford to pay its workers, rather than do so out of an honest attempt to reform. The lack of political freedom, hegemonic leaders, and extreme lack of a dependable judiciary may demonstrate that the economic policy effect could be in operation due to this semi-statism.

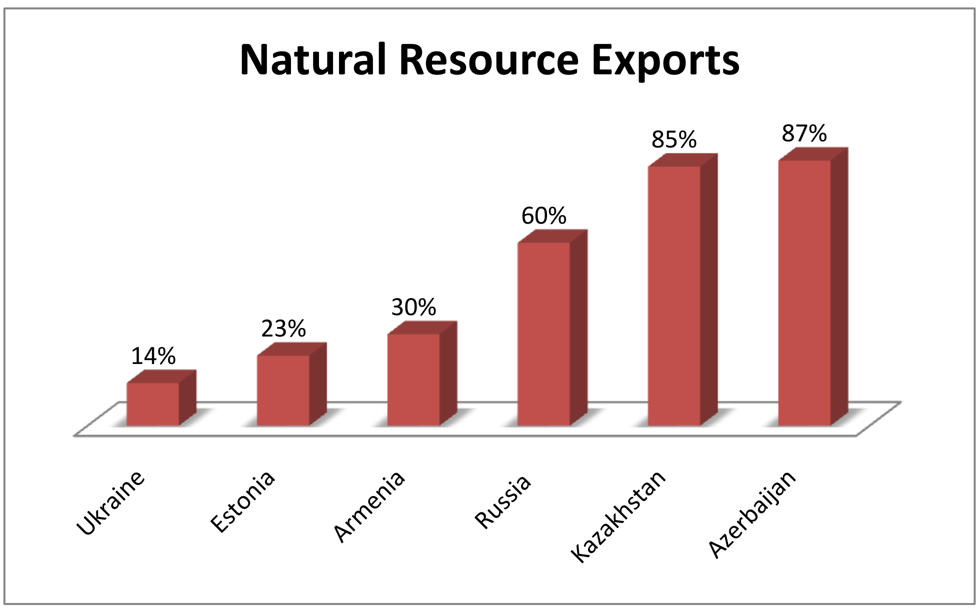
This may be attributed to its large border with Russia, a power that remains a major buyer of the state's natural gas. Second to Estonia, Kazakhstan has seen the largest amount of per capita GDP growth. It grew from 1,425 constant 2000 US dollars per capita in 1991 to $2,166 in 2006. However, this growth is not matched by other standard of living measures, with the lowest life expectancy of 66 years. Infant mortality fell from 48 deaths per 1,000 live births in 1995 to 29 in 2006, which is relatively high. Likely due to its resources, foreign direct investment accounted for 7.7% of GDP in 2006 (World Bank Group 2011). It will be interesting to witness changes that occur over the next few decades as Kazakhstan attempts to expand its customer base to China and other areas in Central Asia. Perhaps if this state can gain some economic distance from Russia, a state that very much wants a reunited Soviet Union, Kazakhstan can better increase its chances at full reform.

Cross-Comparisons

In this section, the information given in the country profiles will be presented graphically in order to compare the overall development between states, and to test the original thesis.

Overall Resource Exports

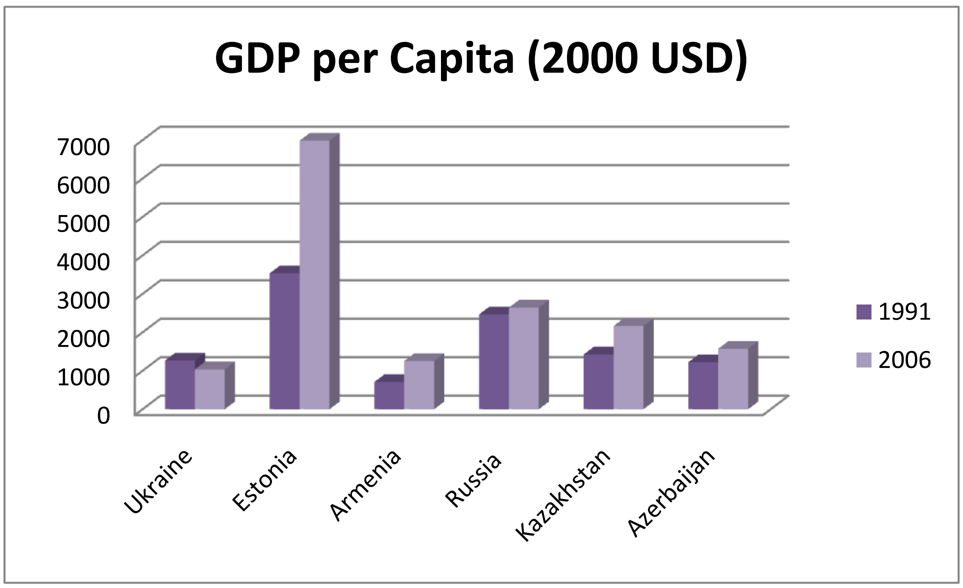
Graph 2.1 allows us to compare the relative level of resource exports given in the previous section. The separation between the first three states and the second three should demonstrate which states will have higher levels of democracy. Also note that one state from each side, Ukraine and Kazakhstan, is affected by the "tap" or "transit weapon."



Graph 2.1 Source: World Bank Group, World Development Indicators 2010

Changes in GDP per Capita

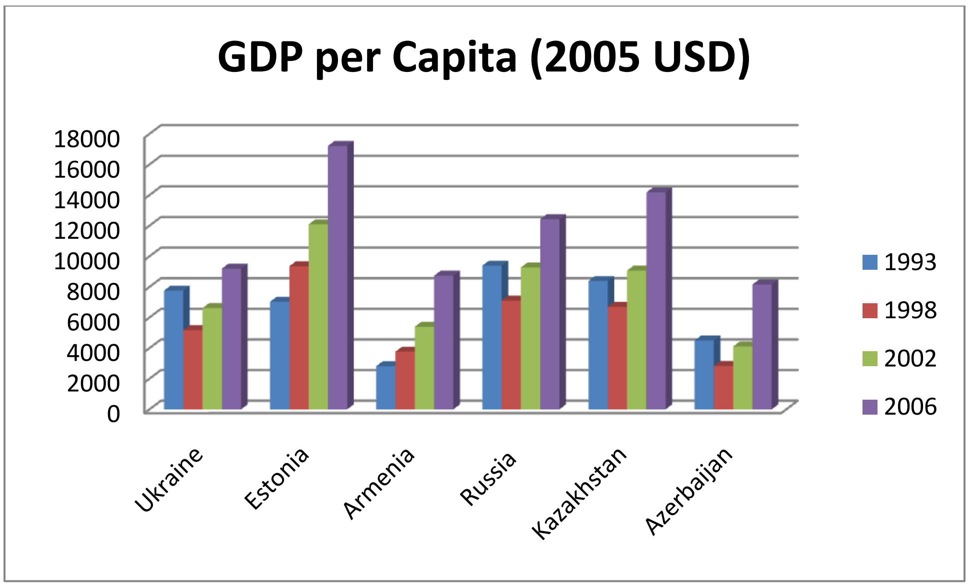
Graph 2.2 gives a general sense of the standard of living improvements that have taken place fifteen years after the union's collapse. Russia, Kazakhstan, and Azerbaijan have been able to make some improvements with their resource wealth, but not nearly to the same extent as Estonia, which had the most consistent reform policies. Ukraine, a state subject to Russia's "tap weapon" experienced a negative change, reflecting the state's stalled reform and pervasive corruption. Although minimal, Armenia has also seen growth despite it conflict with Azerbaijan.



Graph 2.2 Source: World Bank Group, World Development Indicators 2010

It is also useful to compare the states at different time intervals throughout each transition using a different data source. Creating graphs using Penn World Tables data, Graph 2.3 compares how each state progressed during the transition, mostly during the Russian economic crisis. In order to produce a less chaotic graph, the countries have been separated by state rather than by year. First looking at Estonia and Armenia, steady growth can be seen at each time period, although the magnitude between each state greatly varies. The 1998 crisis in Russia appeared to have had the largest effect on Ukraine, the state subject to Russia's "tap weapon."

The latter three states were all affected by the crisis, but were able to make a recovery and resume growth by 2002. However, it is important to note that within these states, particularly in Azerbaijan, it was established that the gap between rich and poor has been sharply increasing. Therefore, these numbers do not necessarily represent an increase in quality of living standards.

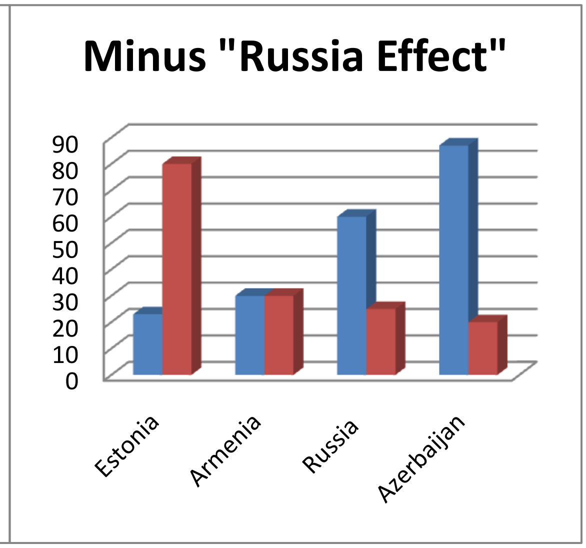


Graph 2.3 Source: Penn World Tables 2009

Natural Resource Exports vs. Freedoms

In regards to our thesis that states with higher natural resource exports should have lower levels of certain freedoms, this sub-section will show that while not every state is a perfect example, an overall relationship is still present. By first graphing all states, but then isolating the four states who are not subject to Russia's tap or transit weapon, a clearer relationship can be seen between the levels of exportable natural resources and certain freedoms. Because Estonia, Armenia, and Azerbaijan do not have Russian pipelines and do not share large borders with Russia, they are more likely to take a transitional path separate from Russian policy goals.

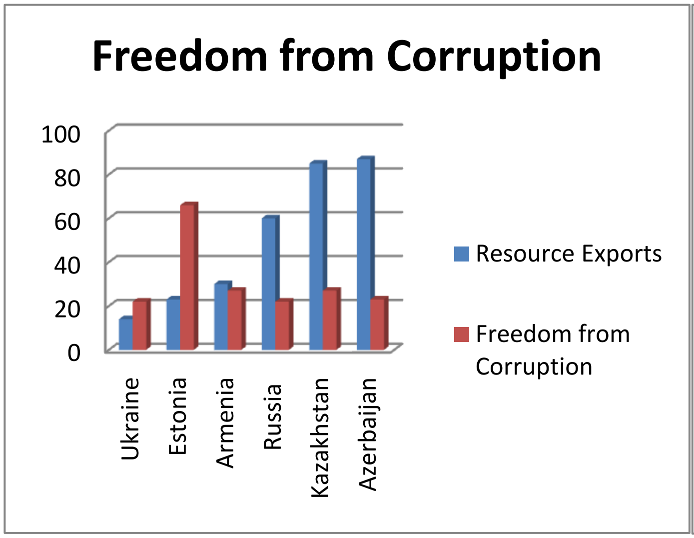
Graph 2.4 Sources: World Bank Group, World Development Indicators 2010 and the Heritage Foundation 2011

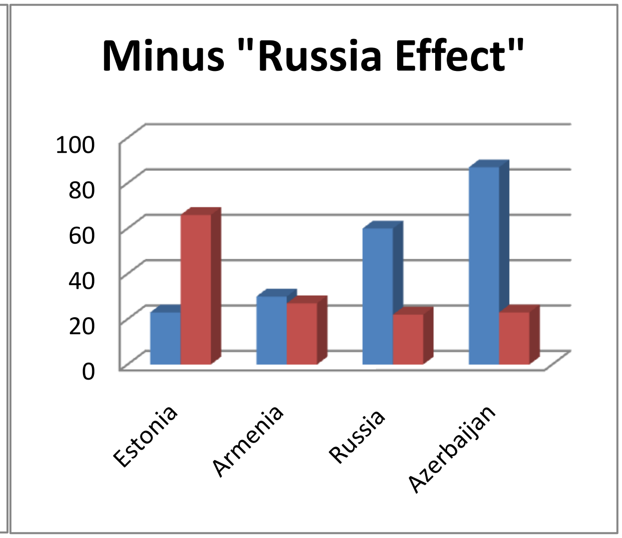


Graph 2.5 Sources: World Bank Group, World Development Indicators 2010 and the Heritage Foundation 2011

The first graphs will look at economic freedoms, specifically property rights and freedom from corruption. These values have been taken directly from the Heritage Foundation values and World Bank data used in the previous section without alteration. Looking at property rights, the largest contrast exists within the last three states, although Estonia appears to be the only exception among the overall poor scores. However, by removing Ukraine and Kazakhstan, who apply to the “Russia effect,” an inverse relationship becomes clear, showing Estonia and Azerbaijan as nearly symmetrical bookends.

The next cross-comparison, freedom from corruption, shows a similar outcome when removing the “Russia effect” states. Estonia is again the exception among the six states, with the others receiving poor scores due to weak judicial systems and bribery.

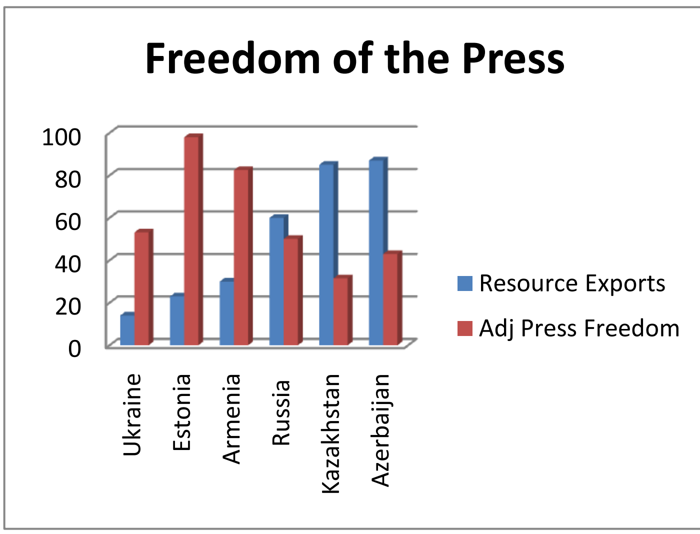




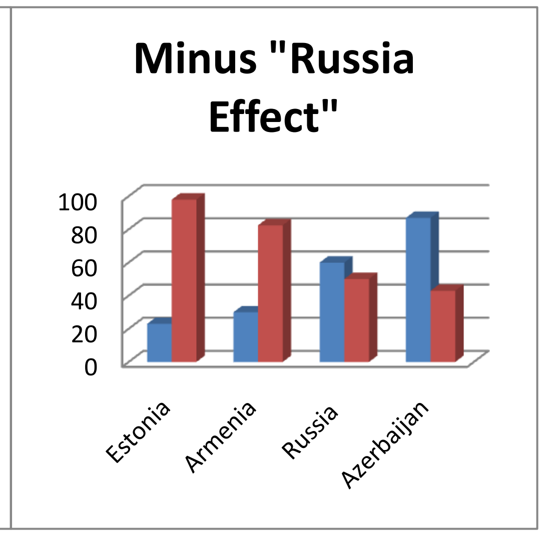
Graph 2.6 Sources: World Bank Group, World Development Indicators 2010 and the Heritage Foundation 2011

Graph 2.7 Sources: World Bank Group, World Development Indicators 2010 and the Heritage Foundation 2011

Press freedom, an essential component of a free state, also correlates with levels of exportable natural resources. Adjusting each state's freedom of the press score by subtracting it from 100, the same inverse relationship is observed. In this comparison, Armenia and Estonia have been given high scores, showing Armenia's tendency towards transition, despite its level of corruption. Recall that Armenia was given a civil liberties score two points higher than its political rights score by Freedom House (2010), showing that despite election fraud and oppression that occurs in Nagorno-Karabakh, Armenian citizens live in a "Partly Free" state. Perhaps with the settling of this conflict, the free press could help Armenia to progress in its transition.



Graph 2.8 Sources: World Bank Group, World Development Indicators 2010 and Reporters without Borders USA 2010



Graph 2.9 Sources: World Bank Group, World Development Indicators 2010 and Reporters without Borders USA 2010

Conclusion

In terms of our original thesis, it appears as though there is a relationship between a state's level of exportable natural resources and its political and economic freedoms. Although several caveats do occur, the effects of state-owned enterprises and corruption are clearly visible within all three of our resource-endowed states. In the remaining three, either reform has been successful and progress has been seen or political turmoil in the form of international conflict or internal squabbles have derailed this process. Given the success in states like Poland, Hungary, and the Czech Republic that were not covered in this paper, states without resource endowments and a desire for reform can have successful transitions into modern economies with strong institutional foundations. Returning to the section on transition economics, the fragility of the reform process has become clear throughout our exploration of each state, as well as where faltering transitions began to deter from the advice of transition economists.

In regards to the future, Peter Murrell stated in 1996 (34) that "it will take a generation, or more, for the legal system to buttress capitalism in the manner imagined by the drafters of the many new laws." After examining what had occurred during this time period, it may be the case that another decade is required for some economies to flourish, if they decide to commit to real changes. However, we have seen that several obstacles distract from this goal, offering ways to maintain GDP without suffering through the hardship of economic liberalization and letting go of lucrative industries. It may be the case the resource-rich states will not reach a point of serious reform until resource revenue is no longer available. Until that time, it is safe to predict that these states will have fewer political freedoms and economic opportunities due to a resource-controlling central government.

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Appendix A: General Characteristics of Each Political Rights and Civil Liberties Rating

POLITICAL RIGHTS

Rating of 1 – Countries and territories with a rating of 1 enjoy a wide range of political rights, including free and fair elections. Candidates who are elected actually rule, political parties are competitive, the opposition plays an important role and enjoys real power, and minority groups have reasonable self-government or can participate in the government through informal consensus.

Rating of 2 – Countries and territories with a rating of 2 have slightly weaker political rights than those with a rating of 1 because of such factors as some political corruption, limits on the functioning of political parties and opposition groups, and foreign or military influence on politics.

Ratings of 3, 4, 5 – Countries and territories with a rating of 3, 4, or 5 include those that moderately protect almost all political rights to those that more strongly protect some political rights while less strongly protecting others. The same factors that undermine freedom in countries with a rating of 2 may also weaken political rights in those with a rating of 3, 4, or 5, but to an increasingly greater extent at each successive rating.

Rating of 6 – Countries and territories with a rating of 6 have very restricted political rights. They are ruled by one-party or military dictatorships, religious hierarchies, or autocrats. They may allow a few political rights, such as some representation or autonomy for minority groups, and a few are traditional monarchies that tolerate political discussion and accept public petitions.

Rating of 7 – Countries and territories with a rating of 7 have few or no political rights because of severe government oppression, sometimes in combination with civil war. They may also lack an authoritative and functioning central government and suffer from extreme violence or warlord rule that dominates political power.

CIVIL LIBERTIES

Rating of 1 – Countries and territories with a rating of 1 enjoy a wide range of civil liberties, including freedom of expression, assembly, association, education, and religion. They have an established and generally fair system of the rule of law (including an independent judiciary), allow free economic activity, and tend to strive for equality of opportunity for everyone, including women and minority groups.

Rating of 2 – Countries and territories with a rating of 2 have slightly weaker civil liberties than those with a rating of 1 because of such factors as some limits on media independence, restrictions on trade union activities, and discrimination against minority groups and women.

Ratings of 3, 4, 5 – Countries and territories with a rating of 3, 4, or 5 include those that moderately protect almost all civil liberties to those that more strongly protect some civil liberties while less strongly protecting others. The same factors that undermine freedom in countries with a rating of 2 may also weaken civil liberties in those with a rating of 3, 4, or 5, but to an increasingly greater extent at each successive rating.

Rating of 6 – Countries and territories with a rating of 6 have very restricted civil liberties. They strongly limit the rights of expression and association and frequently hold political prisoners. They may allow a few civil liberties, such as some religious and social freedoms, some highly restricted private business activity, and some open and free private discussion.

Rating of 7 – Countries and territories with a rating of 7 have few or no civil liberties. They allow virtually no freedom of expression or association, do not protect the rights of detainees and prisoners, and often control or dominate most economic activity.

Appendix B: Property Rights

Each country is graded according to the following criteria:

- **100**—Private property is guaranteed by the government. The court system enforces contracts efficiently and quickly. The justice system punishes those who unlawfully confiscate private property. There is no corruption or expropriation.
- **90**—Private property is guaranteed by the government. The court system enforces contracts efficiently. The justice system punishes those who unlawfully confiscate private property. Corruption is nearly nonexistent, and expropriation is highly unlikely.
- **80**—Private property is guaranteed by the government. The court system enforces contracts efficiently but with some delays. Corruption is minimal, and expropriation is highly unlikely.
- **70**—Private property is guaranteed by the government. The court system is subject to delays and is lax in enforcing contracts. Corruption is possible but rare, and expropriation is unlikely.
- **60**—Enforcement of property rights is lax and subject to delays. Corruption is possible but rare, and the judiciary may be influenced by other branches of government. Expropriation is unlikely.
- **50**—The court system is inefficient and subject to delays. Corruption may be present, and the judiciary may be influenced by other branches of government. Expropriation is possible but rare.
- **40**—The court system is highly inefficient, and delays are so long that they deter the use of the court system. Corruption is present, and the judiciary is influenced by other branches of government. Expropriation is possible.
- **30**—Property ownership is weakly protected. The court system is highly inefficient. Corruption is extensive, and the judiciary is strongly influenced by other branches of government. Expropriation is possible.
- **20**—Private property is weakly protected. The court system is so inefficient and corrupt that outside settlement and arbitration is the norm. Property rights are difficult to enforce. Judicial corruption is extensive. Expropriation is common.
- **10**—Private property is rarely protected, and almost all property belongs to the state. The country is in such chaos (for example, because of ongoing war) that protection of property is almost impossible to enforce. The judiciary is so corrupt that property is not protected effectively. Expropriation is common.
- **0**—Private property is outlawed, and all property belongs to the state. People do not have the right to sue others and do not have access to the courts. Corruption is endemic.

Sources. Unless otherwise noted, the *Index* relies on the following sources for information on property rights, in order of priority: Economist Intelligence Unit, *Country Report* and *Country Commerce*, 2008–2010; U.S. Department of Commerce, *Country Commercial Guide*, 2008–2010; U.S. Department of State, *Country Reports on Human Rights Practices*, 2008–2010; and various news and magazine articles.

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Admittance into the Schreyer Honors College under Economics- compled undergraduate thesis on economic transitions in the former Soviet Union
Expected Graduation May 2011

Internship Experience:

UNESCO/Kosciuszko Foundation Teaching English in Poland Program **July 2010**
Teaching Assistant/Teacher

- Worked with teachers and Polish staff to encourage English speaking for Polish students ages 11-19
- Assumed teaching and student newspaper responsibilities in the final week of classes due to teacher's absence
- Also included extracurricular and travel activities with students

Connecticut State Legislature Education Committee **May-August 2009**
Intern/ Legislative Aide for Representative Andrew Fleischmann-Committee Chair

- Assisted with constituent correspondents, including letter writing and management
- Acted as legislative aide for several weeks
- Completed a research paper on standardized testing, which may be used as a tool in drafting future legislation

Larson for Congress **May-August 2008**
Campaign Intern under Geoff Luxenberg (860) 335-2023

- Assembled campaign headquarter and assisted in fundraiser planning
- Drafted press releases, letters of recommendation, and worked extensively with the campaign database

Connecticut State Legislature Environment Committee **May-August 2007**
Committee Intern for State Senator Bill Finch under Jason Bowsza (860)558-1705

- Assisted with constituent correspondence
- Performed data entry, phone banking and literature distribution for Senator Finch's Mayoral campaign in Bridgeport, Connecticut