

Is the USSR dead? Experience from the financial and economic crisis of 2008–2009

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Abstract

The paper examines the economic linkages between the post-Soviet states from the point of view of the financial and economic crisis of 2008–2009. It aims to find out whether the interdependence between the countries of the former Soviet Union is still large enough that crises in individual countries affect the economic development in the neighboring states, and assesses the impact of the crisis itself on the linkages between the former Soviet republics. The evidence is mixed: while some channels of interdependence deteriorated over the last decade, others became more important, and some were even strengthened by the crisis itself.

Keywords

- Crisis of 2008–2009;
- Crisis of 1998–1999;
- Trade;
- Investments;
- Migration;
- Post-Soviet states

1. Introduction

The consequences of the collapse of the Soviet Union for the economic linkages between its former republics have been extensively debated in the literatures. The fact that the fragmentation of the Soviet economy resulted in a significant reduction of trade, investment and migration ties between the new independent states is hardly in question (Pomfret, 2002); it was caused not merely by the collapse of the USSR, but also by the destruction of the mechanism of coordination between enterprises, which existed in the planned economy, and the transition recession. However, the extent of this fragmentation is not entirely clear. The experience of the colonial empires of the European nations demonstrates high level of path dependence of trade and investment ties (Frankel, 1997; Lundan and Jones, 2001; Head et al., 2010). And the degree of integration of the former Soviet Union (FSU)¹ republics was more significant than that of former colonial empires.²

The empirical literature on trade between the FSU states, on the one hand, documents the decline of intra-regional connections, but on the other hand, finds the trade to be significantly higher than the econometric models would predict (Fidrmuc and Fidrmuc, 2003; Freinkman et al., 2004; De Sousa and Lamotte, 2007).³ From the point of view of investments, post-Soviet space plays an important role for the emerging Russian multinationals, although the latter seem to expand toward non-regional markets as well after a certain period of time (Crane et al., 2005; Vahtra, 2009; Hanson, 2010; Filippov, 2010). A sub-group of new multinationals in the region are direct successors of the former all-union enterprises (Filatotchev et al., 1993). In the area of migration

there is evidence of a surge of cross-border flows in the last decade, motivated by the increasing attraction of Russia and Kazakhstan for the labor migrants from other post-Soviet states (Korobkov, 2007). Thus, the extent of economic ties between the FSU states is significant, but the dynamics is more difficult to evaluate and seems to diverge for different aspects of interdependencies.

This paper discusses this topic from a different perspective. We consider the global economic crisis of 2007–2009 as a lythmus test of the degree of interdependence of the post-Soviet countries. It is well known that the hopes of some post-Soviet leaders to create an “island of stability” (as the Russian economy was described by the finance minister Aleksei Kudrin in 2008, cited in Lyashchenko and Nechyaeva, 2008) during the global instability ultimately proved unjustified. The region was strongly hit by the global crisis in 2008–2009 (see Smith and Swain, 2010; Drahokoupil and Myant, 2010; Bideleux, 2011; Connoly, 2012 on various paths of economic crisis in the FSU; Gallego et al., 2010 and Aslund, 2010 investigate the crisis in the Central and Eastern Europe). Hence, considering insofar economic linkages between post-Soviet countries have contributed to this decline and were affected by the decline itself could be a way to evaluate the extent of economic integration in the region. The extent to which economic shocks are transmitted across countries has been acknowledged in the economics literature as a possible indicator of the economic integration (e.g. Choe, 2001).

The crisis of 2008–2009 is not unique in terms of the external economic turbulences influencing most of the post-Soviet countries. Ten years ago the global crisis of 1997–1999, which originated in Asia-Pacific region, affected the economies of the FSU, resulting, among other things, in the catastrophic currency crisis in Russia in August 1998. These two crises offer us an interesting comparative set up: we can document the changes in the degree of integration of the FSU region comparing these two events. There are three main topics we investigate. First, we evaluate the extent of economic integration in the FSU comparing the role of two channels of crisis spillover: the intra-regional linkages (when the crisis in some of the FSU countries was caused by the economic decline in other countries) and the external impact (when all countries of the FSU were simultaneously hit by the global economic decline). Second, we look at the influence of the crises as such on the economic integration in the FSU. Third, we study the policy responses to the crises in terms of the intergovernmental cooperation. The paper is focused on the cross-border linkages, although one has to acknowledge the importance of the domestic factors influencing the propensity of the countries to be influenced by the crisis; our focus on the cross-border ties is determined merely by the research question investigated in this study.

The paper is organized as follows. The next section starts with a note on the timing of the crisis necessary for the subsequent investigation. The third section attempts to identify the relative importance of the post-Soviet linkages in terms of the crisis transmission. The fourth section looks at the impact of the crisis on the economic integration in the FSU. The fifth section compares the crisis of late 2000s with our benchmark of late 1990s in terms of its structure, impact and policy reaction. The last section concludes.

2. Timing of the crisis

Before we proceed to the investigation of the crisis itself, it is necessary to briefly discuss the timing of the global crisis and the crisis in the FSU, which will guide the selection of indicators for our analysis. As for many other crises, the precise timeline is difficult to establish. The starting point of the *global* crisis is typically assumed to be the bank run of August 2007, and the recession in the US lasted between the fourth quarter of 2007 and the third quarter of 2009 (Gorton and Metrick, forthcoming).⁴ However, negative consequences have been felt long after the end of the crisis (e.g. slow recovery of the labor market); for Europe the acute problems of public debt resulted in a new recession in most countries in 2010–2012 (Bordo, 2012). The crisis of 2007 originated in the US, but soon took the global proportions, also leading to enormous decline of international trade (Levchenko et al., 2010), but individual countries were affected by the crisis at different points of time.

For the *FSU*, the following timeline can be established. The first country to suffer from the global crisis already in late 2007-early 2008 was Kazakhstan, because of its banking system heavy dependence on external financing. However, at the same time other post-Soviet countries did not experience any economic decline yet – on the contrary, high commodity prices supported strong economic growth in Russia and some other countries throughout most of 2008. The crisis hit the FSU in the fourth quarter of 2008 (Berglof et al., 2010). In terms of the quarterly macroeconomic indicators (real GDP, industrial production) the spread of the crisis in the FSU was more or less synchronized: the slowdown of growth rates began in most countries in the second half of the year 2008 and economic downturn (in those countries which suffered it) from the beginning of year 2009. There was a 3–6 months difference in terms of the entry point into the crisis. All FSU countries experienced a decline of industrial production during the crisis on the quarterly basis; as for the GDP, several countries exhibited merely a slowdown of growth (although often a substantial one – for Belarus, for example, the annual growth rate for 2009 dropped more than by 10 percent points).

As of mid-2010, almost all FSU countries experienced several consecutive GDP and industrial production growth quarters, allowing us to conclude that the recession was over. The exit from the crisis happened almost simultaneously (see Golovnin et al., 2010). In terms of economic recovery, in 2010 all FSU countries (with the exception of Armenia and Ukraine) reached the pre-crisis level of the GDP.⁵ Hence, throughout the paper, we use the following approach. For annual indicators, we define 2008 as the last pre-crisis year, 2009 as the year of the crisis, and 2010 as the first post-crisis year. For quarterly data, we define the last quarter of 2008 as the first crisis period. As a caveat, we have to acknowledge that the imbalances caused by the crisis last longer than the crisis itself (e.g. changes in behavior of consumers and companies), as do structural weaknesses of post-Soviet countries, which contributed to the development of the crisis (e.g. resource-dependency, low competitiveness of manufacturing etc.). We do *not* argue that all economic problems of the post-Soviet countries disappeared as of 2010 – on the contrary, many of them were intensified by the crisis and persist. In addition, new events (like the ongoing public debt crisis in the Eurozone) could again create adverse external shocks, amplifying the existing problems and leading to new waves of crisis. It goes beyond the framework of this article to discuss the prospects of post-Soviet economies in greater detail, yet we should acknowledge that possible new waves of the crisis could provide us with new tests for the persistence of economic ties in the FSU in the coming years.⁶

3. Crisis transmission in the FSU

3.1. Trade

As the first step of our analysis, we attempt to evaluate the contribution of the intra-regional economic linkages to the overall economic decline in the FSU. If the linkages between the post-Soviet countries are minor, there are no reasons to expect them to contribute to the economic decline. On the contrary, if the countries are still highly interdependent, the intra-regional spillovers should play the dominant role. From this point of view, we will examine two main linkages: migration and trade.

The most obvious potential crisis transmission channel is associated with the decline of trade relations. The self-enforcing mechanism in this case is the following: increasing economic difficulties in some countries result in the contraction of cross-border trade, which in turn facilitates economic decline. In the FSU a substantial portion of intra-regional trade is still determined by the technological and resource interdependence between enterprises, which are forced to rely on contractors from the old Soviet times: in some cases finding another contractor requires the change of the entire equipment used by the company. The disruptions in this chains caused by the crisis can be both supply and demand-driven (e.g. increase of prices on the supply side or decreasing demand for parts and raw materials due to the decreasing production of final output goods). In both cases, companies lose crucial suppliers or customers and, in turn, have to reduce their production, causing secondary effects on other enterprises and on the economy overall.

In order to check whether trade did matter in this context, we first look at the relative contribution of the decrease of exports to the FSU to the total decrease of exports (and a respective indicator for imports). If it is large, the disruptions of trade were primarily caused by the post-Soviet linkages; if it is small, trade with extra-regional partners suffered to a greater extent. We compute this indicator, as mentioned, defining 2008 as the last pre-crisis year, and 2009 as the year when crisis hit the FSU (Figs. 1 and 2). On the x -axis in both figures we present the post-Soviet share of foreign trade (export for Fig. 1 and import for Fig. 2) for the year 2008. It means that zero on the x -axis corresponds to a case when a country had zero trade with other FSU countries before the crisis hit. The farther away the observation is from zero along the x -axis,

the larger was the pre-crisis share of trade with the FSU. On the y -axis, we present the relative contribution of the FSU trade (again, export for Fig. 1 and import for Fig. 2) to the overall decline of the foreign trade in 2009 (in percent). Zero on this axis corresponds to the case when the trade with the FSU did not contribute at all to the decline of foreign trade in the year of crisis, so that the total reduction of foreign trade in 2009 was due to the extra-regional trade. The larger the value is on the y -axis, the larger is the relative contribution of the FSU trade to the decline of foreign trade; if it is equal to 100%, it means that the only reason why foreign trade declined in 2009 was that the trade with the FSU declined (trade with other partners did not decline at all). Fig. 2 has also to deal with two special cases, for which no decline of total imports in 2009 was observed at all: Turkmenistan and Kyrgyzstan. For these two observations we artificially set the coordinates on the y -axis equal to zero (since, obviously, if the trade did not decline, computing the contribution of the FSU trade to this decline is impossible).

Fig. 1. Share of the FSU in the overall decline of exports during the crisis and economic openness. Note: the contribution to the decline of exports (i.e. the value on the y -axis) was calculated as follows: $(\text{Export to the FSU in 2009} - \text{Export to the FSU in 2008}) / (\text{Total export in 2009} - \text{Total export in 2008})$. The calculations are based on the data from the IMF Directions of Trade Statistics (DOTS). Share of exports in GDP (2008) as reported by the World Bank (World Development Indicators). Dotted line represents the 45-degree line.

Fig. 2. Share of the FSU in the overall decline of imports during the crisis and economic openness. Note: the contribution to the decline of imports (i.e. the value on the y -axis) was calculated as follows: $(\text{Import to the FSU in 2009} - \text{Import to the FSU in 2008}) / (\text{Total import in 2009} - \text{Total import in 2008})$. The calculations are based on the data from the IMF Directions of Trade Statistics (DOTS). Share of exports in GDP (2008) as reported by the World Bank (World Development Indicators). Dotted line represents the 45-degree line.

One can see that for several post-Soviet countries the contribution of the intra-regional trade to the overall decline of trade is very large: it accounts for more than 40% for exports for Armenia, Belarus, Moldova, Uzbekistan and Turkmenistan and for imports for Azerbaijan, Belarus, Kazakhstan, Uzbekistan and Tajikistan. Decline of intra-regional imports have therefore been more important for Central Asia and Azerbaijan; exports affected smaller FSU countries still economically dependent on the Russian market (Moldova) as well. For both exports and imports there was a strong effect for Belarus (which is probably due to the increasing competitive pressure on the Russian market with customers becoming more 'selective' during crisis). Unsurprisingly, the effect of FSU trade was the strongest for countries, which also have very high share of exports and imports coming to and from the FSU. The correlation coefficient between the contribution of the FSU trade to the overall trade decline and 2008 share of FSU trade is 0.73 for export and 0.62 for import (excluding countries, which did not experience any decline of import at all).⁷ There are, however, several special cases to be mentioned.

Turkmenistan and Kyrgyzstan did not experience any decline of imports from the FSU, and both have a notable (30.1% and 53.7%, respectively) share of intra-regional imports. On the contrary, for Uzbekistan with only moderate share of FSU imports, the latter became the major source of

overall contraction of imports. The reasons for these special cases could be associated with specific industrial structure of trade. Turkmenistan's main imports from Russia are machinery and equipment – if the latter were supplied based on long-term contracts (what is highly probable for this country, given that it still has state-owned planned economy), the reaction to the crisis could be small. Kyrgyzstan mostly imports fuel and food, while the former did decline, the latter was less affected. Uzbekistan has a high share of pulp and paper products from Russia in its imports, which is likely to decline during crisis.

For exports Kyrgyzstan, which has a high FSU trade share (47.8%), did experience only marginal contraction. The reason is the following: in 2008 Kyrgyzstani exports grew significantly because of high gold prices on international markets. In 2009 most of the decline of exports was simply associated with reversing this effect. A large portion of exports of Turkmenistan is also directed to the FSU countries (57.1%). From the statistical point of view, in terms of exports this country is not an outlier: a large share of the FSU trade was followed by a very large contribution of the FSU trade to the overall decline of trade. However, the mechanisms underlying this process are different than for other post-Soviet countries and, strictly speaking, are not related to the crisis, probably capturing the effect of two extraordinary events. In 2009 Uzbekistan's trade with the FSU was mostly determined by the export of gas to Ukraine (through the Russian territory). In April 2009 the export was disrupted by an accident in the pipeline connecting the country to the Russian gas network. Thus, any exports of gas were stopped. In addition, in the second half of 2009 Russia and Turkmenistan entered a period of difficult negotiations over gas prices, which were resolved only by early 2010 and prevented the Turkmenistani gas from being exported before.

Establishing that FSU trade contributed substantially to the decline of the overall trade for several post-Soviet countries is, however, not enough if one wants to show that FSU trade played an important role as a channel of crisis transmission. For this purpose not only trade disruption, but also overall *economic openness* should be large. Indeed, if a country experiences a strong decline of trade, but foreign trade as such is relatively unimportant for its economy, this decline can be relatively painless. Economic openness is typically measured as *share of foreign trade (exports or imports) to GDP*. Fig. 1 compares the contribution of the FSU to the decline of exports to the economic openness of the FSU countries; and Fig. 2 repeats this exercise for imports. Basically, almost all countries, for which FSU trade had a strong impact on the decline of either exports or imports have high level of openness to foreign trade. But there are exceptions: Armenia for exports (although the exports to the FSU went down dramatically, overall exports of Armenia relative to its GDP are relatively small) and Azerbaijan for imports.

3.2. Migration

The skyrocketing labor migration among the post-Soviet countries (with Russia and Kazakhstan serving as target countries and Tajikistan, Kyrgyzstan, and, to some extent, Moldova, Ukraine, Armenia and Uzbekistan, as countries of origins of migrants) is, as mentioned, probably the most interesting change in the economic links between the post-Soviet states in the last 10 years. It is substantially different from both the Soviet-period migration (directed by the needs of large projects of the planned economy) and the first wave of post-Soviet migration in the early 1990s (to a very large extent determined by the movement of ethnic Russians from the new independent states into the Russian Federation caused by political reasons). Currently migration is mostly temporarily and economically motivated: migrants are attracted by higher salaries and better job opportunities. It also means that migrants usually keep contacts with the countries of their origin and, what is especially important, send large remittances to their home countries; in Tajikistan, Kyrgyzstan, Armenia and Moldovas these payments account for more than 10% of the GDP, according to the World Bank (2010) estimates (in Tajikistan more than 40%). The economic recovery of these countries in the 2000s, as well as partly of Ukraine and Uzbekistan, is claimed to have been strongly influenced by the flow of remittances (Grigoriev and Salikhov, 2006).

The data published by the official authorities of the CIS suggest that the crisis had a severe

impact on the migration flows and remittances.⁹ The number of officially registered migrants in Russia went down from 13.5 mln. people in 2008 to 4.5 mln. in 2009. The remittances from Russia to the FSU also went down dramatically. The Russian balance of payment data suggest a decrease of total transfers to the FSU by 22% in the fourth quarter of 2008 and a further drop of 22% in the first half of 2009 (as opposed to the fourth quarter of 2007 and the first half of 2008 respectively); the share of migrants in the total transfers decreased as well. Similar trends have been observed in Kazakhstan from the beginning of 2008 on, with temporary recovery in mid-2009. National statistics of Moldova, Tajikistan and Armenia reveal a similar pattern. Furthermore, during the crisis the average size of the transfer dropped significantly (see Golovnin and Yakusheva, 2011). The fall of remittances is acknowledged to be the key channel of crisis transmission for a number of the FSU countries with a profound impact on their economies in a number of studies (Lukashova and Makenbaeva, 2009; Yudaeva and Kozlov, 2010; ICG, 2010; Myant and Drahokoupil, 2012).

The reason why cross-country migration and remittances reacted so strongly on the crisis is associated with its two important features of post-Soviet labor migration. On the one hand, it heavily relies on informal contracts, which provide very limited employment protection. On the other hand, the market is clearly demand-driven: there exists a persistent and robust excessive supply of labor migrants in the post-Soviet countries, which can be used by Russian and Kazakhstani companies. This is strengthened by the fact that many migrants are employed in low-skill sector. Employers can easily adjust to the changing external environment by firing the migrant workers. This is precisely what according to the data reported above happened during the crisis. These processes have been facilitated by the fact that many migrants are employed in the construction industry, which suffered heavily from the crisis.

To conclude, the intra-regional spillovers did play a substantial role in the spread of the global economic crisis in the post-Soviet space, particularly through the decrease of cross-border trade and drop in migration flows and remittances. Both effects seem to have primarily affected some countries of Central Asia; in case of trade Belarus also suffered substantially. Other post-Soviet countries seem to have been less affected by the intra-regional crisis transmission channels. The most obvious examples are Azerbaijan and Georgia (for the latter a major drop of economic ties to the FSU has been observed much earlier due to political hostilities to Russia and the war in 2008), but also Ukraine seems to be less influenced by the intra-regional developments and more by the contraction of demand for its exports in Europe. In the same way, Kazakhstan was influenced rather by extra-regional factors (Myant and Drahokoupil, 2013); in this case it is evident from the timing of the crisis as well.

4. Economic crisis and post-Soviet economic linkages

4.1. Trade and migration

In the next step, this section aims to understand whether the crisis itself resulted in strengthening disintegration of the post-Soviet space. The answer to this question does not follow straightforwardly from the observations made so far. In fact, even although the crisis unambiguously resulted in a decline of cross-border linkages, one could hypothesize that the drop in the intra-regional interdependencies in the FSU was smaller than that between the FSU states and their external partners, so that the post-Soviet trade and factor flows actually became relatively *more* important for the FSU. One should also consider the possibility of a “substitution effect”, when global contraction made room for an increase of the intra-regional linkages.

Let us first consider the effect of the crisis on trade patterns. Fig. 3 represents the changes of intra-regional export and intra-regional import shares during the crisis. On the *x*-axis we denote the difference between the share of intra-regional imports in 2009 and the share of intra-regional imports in 2008: thus, if this value is equal to zero, the intra-regional import share in 2009 was exactly the same as in 2008; if the value is positive, intra-regional import share increased in 2009 as opposed to 2008, and if it is negative, the intra-regional import share decreased. On the *y*-axis we denote the difference between the share of intra-regional exports in 2009 and intra-regional exports in 2008: again, the interpretation is that if the value is equal to zero, intra-regional export

share did not change, if it is positive, intra-regional export share increased, and if it is negative, it decreased. In order to make the graph easier to read, we excluded two outliers – Kyrgyzstan with growth of share of exports by 28 percent points and reduction of share of imports by 33 percent points; and Turkmenistan with reduction of share of exports by 23 percent points and imports by 4 percent points.

Fig. 3. Change of the share of intra-regional exports and imports in the FSU (2009 as opposed to 2008) excluding outliers Kyrgyzstan and Turkmenistan, percent points.

Source: own calculation based on IMF DOTS data. Value on the x -axis obtained as: share of FSU imports in 2009 minus share of FSU imports in 2008. Value on the y -axis is obtained as share of FSU exports in 2009 minus share of FSU exports in 2008.

One can see that results differ for exports and imports. The share of intra-regional imports went down for most FSU countries (except Armenia, Tajikistan and Ukraine). The share of intraregional

exports declined for six countries shown on Fig. 3 – Kazakhstan, Russia, Armenia and (marginally) Belarus, Moldova and Ukraine – and increased for the rest of the FSU. While Turkmenistan was excluded from the graph to improve the readability of the figure, for this country, as noticed above, intra-regional export share also declined. Thus, intra-regional exports remained more persistent during the crisis than imports. For exports at least for some countries this persistence could have been driven by a purely statistical effect of commodity prices on the global market. For example, Azerbaijan's exports outside the FSU are mostly driven by energy, while in the FSU this commodity plays an extremely limited role. The crisis resulted in the drop of oil prices, which made the extra-regional export of Azerbaijan to appear to be shrinking dramatically, without affecting the intra-regional trade. For Kyrgyzstan the gold prices, as discussed, played a similar role (see Golovnin and Ushkalova, 2011). The only country for which crisis resulted into an increase of the FSU export and import share was Tajikistan.

It is more difficult to evaluate the persistence of migration during and after the crisis (Marat, 2009), especially because the quality of data is very poor. The described drop in the number of migrants is based on the *official* information: it is possible (even likely) that the crisis caused merely the re-allocation of the migrants to semi-legal and illegal employment. This is also consistent with the drop in remittances (which is easier to trace, with the exceptions of crossborder

movements of cash); decreasing legality of employment was associated with decreasing salaries. For Tajikistani migrants the reduction of salaries has been shown by Olimova and Olimov (2010). A number of studies using micro-level data for Tajikistan have shown that during the crisis the labor emigration from this country actually increased: the reduction of the remittances flow resulted in economic slowdown, which forced the Tajikistani households to send more members abroad as migrants. The migration, however, also became more risky, as the share of migrants without pre-arranged jobs went up (Danzer and Ivashenko, 2010; Kroeger and Meier, 2011). Olimova and Olimov (2010) show that among the Tajikistani migrants, who have lost their jobs, only 3.8% decided to return to their home country: 46.6%, on the contrary, were able to find a new job, and 26.6% stayed in Russia using borrowed money to sustain themselves during the crisis.

Thus, there are reasons to believe that the migration patterns in the FSU have survived the crisis. The same can be said – although with certain lag – about remittances. Fig. 4 reports the data on remittances to several key FSU countries made through money transfer operators from Russia according to the Russian Central Bank (we should acknowledge possible deficits regarding the quality of the data, capturing only a fraction of remittances). One can see that in 2006–2008 remittances were growing to all destinations. The crisis in 2009 resulted in a fall of remittances. In 2010 they returned to the growth path, and while remittances exceeded the 2006–2007 levels, they remained lower than in 2008 (except Ukraine). In 2011, finally, remittances exceeded the 2008 level for most countries (and skyrocketed for Uzbekistan), entirely overcoming the consequences of the crisis.

Fig. 4. Transfers from Russia to a number of FSU countries through money transfer operators, USD mln.

Source: own calculation based on the Russian Central Bank data.

4.2. Foreign direct investments

An area where the substitution effects of the crisis have been particularly pronounced is that of foreign direct investments (FDI). In the last years before the crisis intra-regional FDI flows in the FSU, particularly associated with companies from Kazakhstan and Russia, increased significantly. As late as in the first half of 2008, before the stock market collapse in September, Russian businesses initiated a number of ambitious investment projects abroad (Kuznetsov, 2009). However, the fast economic decline and associated contraction of bank lending (required to finance the wide-scale international expansion) forced the post-Soviet multinationals to reevaluate

their expansion plans; the FDI flows went down.

Fig. 5 summarizes the share of Russian and Kazakhstani outward investments in the total investments in selected FSU in 2006–2009.¹⁰ For Kazakhstan the share of investments in both countries, for which the data is available (Russia and Kyrgyzstan) unambiguously went down during the crisis, probably because the banking sector (which was crucial for the emerging Kazakhstani multinationals) was strongly affected. For Russia, however, with the only exception of Kazakhstan the *relative* share of FDI actually increased. In *absolute* terms statistical agencies of both Russia and the target countries for its FDI report a decline in the investment flows, but relatively speaking this decline was smaller than that of FDI from other sources. In some cases (specifically, Kyrgyzstan, which has been one of the primary targets of Kazakhstani FDI in the second half of the 2000s, see Libman, 2013) the increase of the role of Russia is primarily *due* to the decline of Kazakhstan, but in other FSU states it seems to be rather related to the extraregional

investment flows. Hence, Russian FDI in the post-Soviet space are relatively resilient and robust.

Fig. 5. Share of Russian and Kazakhstani investments in the total investment inflow (for Ukraine – investment stock) in 2006–2009.

Source: own calculations based on various statistical agencies of the FSU countries.

However, the interpretation of post-Soviet investment statistics should be done with caution, since it often fails to capture the active use of offshore jurisdictions to channel FDI by post-Soviet companies (Libman and Vinokurov, 2012). Therefore it is reasonable to complement the statistical analysis by the consideration of individual cases of projects implemented by the Russian companies in the FSU. From this point of view, the situation seems to be more differentiated. There have been abundant reports of investment deals planned before the crisis and canceled in autumn 2008: most of them come from the construction industry. Several large Russian companies (e.g. *PIK*, *Inteko* and *Mirax Group*) were reported to put their plans in the FSU (mostly in Ukraine) on hold or withdraw from the planned initiatives. However, at the same time there have been at least several examples of large-scale projects, which were initiated *during* the crisis and in some sense became possible because of the crisis. In this case two factors contributed to the Russian investment expansion. First, large companies in the FSU states often experienced more significant decline than Russian investors; therefore in some industries where influential local business groups originally blocked the advancement of Russian multinationals, this restriction disappeared. Second, due to the same reasons some of the political barriers protecting sensitive industries of the FSU countries went down. In addition, Russian government seems to provide support to Russian companies in acquiring assets in the FSU, even during the crisis (see Libman and Golovnin, 2011).

The acquisition of the Ukrainian bank *Prominvestbank* by the Russian state-owned *Vneshekonombank* in 2009 (i.e. at the high point of the crisis) is a good example of new *opportunities* for the Russian business during the crisis. In 2008 *Prominvestbank* ranked sixth according to its assets in Ukraine; however, in October 2008 a bank run caused by the general

advancement of the crisis forced the National Bank of Ukraine to establish a provisional administration in *Prominvestbank* and to start looking for potential external investors. The global crisis, which caused the problems of *Prominvestbank* in the first place, was also the main factor forcing the hand of the National Bank: the investor had to be found as soon as possible, and, according to Vladimir Krotiyuk, deputy head of the National Bank, the offers of the Western financial institutions were rejected since the latter required several months to make the final decision (Krotiyuk, 2009). Thus, the Russian *Vneshekonombank* turned out to be the winner of the race, which, according to its president Vladimir Dmitriev, it even did not intend to enter before the crisis (Dmitriev, 2009). There is no reliable information on the role of the Russian government in this deal, yet it is fair to assume that at least its approval was necessary (since *Vneshekonombank* is a state-owned corporation).

A somewhat similar scenario was observed in Kazakhstan, where *BTA*, one of the largest banking groups of the country, faced significant difficulties during the crisis. As a result, the Kazakhstani government was forced to acquire 75.1% of its shares, immediately stating that the acquisition was of a short-term nature. The search for strategic investor started, and, once again, the Russian *Sberbank* turned out to be one of the leaders of the race. As of June 2009, *Sberbank* was the only bank, which made an official proposal of the stocks acquisition to *BTA*. Unlike the *Prominvestbank* deal, the *BTA* project ultimately turned out to be unsuccessful, since in October 2009 the *BTA* signed a memorandum of understanding with its creditors, effectively providing the latter with the veto power in the key bank's decision and making the acquisition less attractive for the Russian side. However, the key pattern is the same: significant economic difficulties in the FSU make large companies originally controlled by local business groups open to foreign investors, and the Russian business seems to be the first to react.

To conclude, the effect of crisis on economic integration is mixed. For trade, the effects differ for individual countries: for most countries the share of intra-regional imports went down, but the share of intra-regional exports declined only for about a half of our sample. For migration the growth of remittances, which was interrupted by the crisis, was restored in 2010–2011; there is also evidence that labor migration remained persistent during the crisis and merely shifted in semi-legal sector. In the area of foreign direct investments, statistical evidence documents an absolute decline of the Russian investments in the FSU, but in relative terms they became more important for the post-Soviet countries than before the crisis (since FDI from other countries declined to a greater extent). In 2010 Russian FDI in the FSU (as well as elsewhere) seem to have recovered from the crisis: large investment projects planned and initiated before the crisis were merely suspended, but not canceled. Kazakhstan, on the other hand, seems to have lost its position as a major source of FDI outflow in the FSU.

5. Crises of 1998–1999 and 2008–2009 compared

5.1. Extent and mechanisms of the crisis

In order to examine the dynamics of linkages between the FSU countries over time, in the next step, as discussed, we compare the crisis of 2008–2009 with the 1998–1999 crisis. Both of them had a profound impact on the post-Soviet economies, although it differed for different countries (see Table 1). While some states were affected by the crisis in the late 2000s to a much larger extent than by that of late 1990s, other countries experienced a smaller drop of the GDP growth rates. Overall, the magnitude of the effects of the crisis for the FSU seems to be comparable; but the qualitative implications have been different; in the 2000s many economies of the FSU could rely on much better functioning economic institutions and much larger reserves accumulated during the period of rapid growth in the 2000s. Thus, for most of them even a quantitatively large decline of the GDP did not have such disastrous consequences as that in the 1990s, when that crisis followed a deep transformation recession. Nevertheless, in both cases the post-Soviet countries experienced a strong external shock, which is worth investigating.

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1

Throughout the paper, FSU excludes the Baltic countries, which currently are members of the EU.

2

Throughout the paper, “economic integration” refers to the level of economic interdependence and development of cross-border linkages and ties between households and companies of the FSU. It is different from the intergovernmental cooperation in the FSU, which results in establishment of regional integration agreements such as the Commonwealth of Independent States, although intergovernmental cooperation could facilitate economic integration.

3

One typically relies on gravity equations for econometric modeling of trade: in this case trade is assumed to be higher if the size of the GDP of trading countries is larger and the distance between them is smaller.

4

The simplest possible definition of recession is the following: two consecutive quarters of decline of GDP as a mark of starting recession, two consecutive quarters of growth of GDP as a mark of the end of the recession, see Blanchard and Simon (2001). However, one should note that the National Bureau of Economic Research (NBER) does not use this definition anymore, rather defining recession as “a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales” (<http://www.nber.org/cycles/cyclesmain.html>, accessed September 22, 2012). In what follows we will look at both GDP and industrial production to identify a recession in the FSU.

5

Another special case is Kyrgyzstan: it experienced strong growth in 2008, a substantial growth slowdown in 2009, and a decline in 2010, the year when the government of Kurmanbek Bakiyev was overthrown.

6

The timing of the crisis of late 1990s is more difficult to establish, because for several post-Soviet countries it overlaps with transition recession ongoing from the early 1990s (there was merely a stronger decline than in previous years). The stock market crash in South-East Asia happened in 1997. In the post-Soviet countries, the peak of economic decline was the second half of 1998-first half of 1999, and the recovery started in the second half of 1999. Hence, we will define the 1997 as the *last pre-crisis year* and 1998–1999 as the *period of crisis*. In text we will refer to the crisis of 1998–1999. Unlike the 2008–2009 crisis, where the recession was limited to the calendar year 2009 plus the last quarter of 2008, we cannot make this clear characterization for the previous crisis.

7

For seven out of twelve countries the contribution of FSU trade to the decline of export was larger than the share of the FSU in their exports (Armenia, Belarus, Kazakhstan, Moldova, Russia, Turkmenistan and Ukraine). For imports the contribution of the FSU trade to the decline was larger than the share of the FSU trade for seven countries as well: Azerbaijan, Belarus, Georgia, Kazakhstan, Moldova, Russia and Uzbekistan; recall further that in Turkmenistan and Kyrgyzstan overall imports did not decline.

8

Moldova is an outlier in the sense that a large portion of its emigration flows is directed toward the European Union, which also serves as a crucial source of remittances.

9

We will discuss alternative evidence in what follows.

10

Unfortunately, there are big inconsistencies in the information regarding the same FDI flow reported by different countries. Furthermore, different countries provide information for different indicators of foreign investments. We use data on investment flows for all countries except Ukraine, where only the stock data is available.

11

Again, several countries experienced economic decline already before that, but this was the ongoing transition recession, which started in late 1980s-early 1990s.