Explaining Economic Outliers in the Post-Communist Era

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Introduction

Since the dissolution of the Soviet Union in 1991, the former communist states have followed significantly different paths of development. Comparing Poland to Georgia, for example, reveals stark differences in both economic performance and political transformation. Despite sharing similar institutional starting points—marked by economic collapse, political uncertainty, and the need to rebuild and reform—these countries found themselves in vastly different positions just a decade later.

Much of this divergence has been attributed to geographic diffusion: countries in Central and Eastern Europe (CEE) benefited from proximity to the West, which brought stronger incentives and support for democracy and market reform, as well as the possibility of membership in institutions like the European Union (EU).[1] Through this support, they began to significantly outperform their counterparts in Central Asia and the Caucasus. However, differences in economic development also occurred on a regional level within these under-supported countries. These differences cannot be explained by geographic diffusion from the West, as is done with most CEE countries, as the post-communist states in Central Asia and the Caucasus received the same limited interest and support from the West post-1991. While some countries like Kazakhstan and Azerbaijan emerged as regional economic leaders, others have remained much more stagnant.

This paper investigates these regional divergences—which refer to substantial economic differences within regions that share similar circumstances in terms of location and levels of diffusion from the West—as measured by GDP per capita, that occurred in certain former Soviet

[1] Jeffrey S. Kopstein and David A. Reilly, "Geographic Diffusion and the Transformation of the Post Communist World," *World Politics* 53, no.1 (2000): 2.

republics. It poses the question: Why did some countries in Central Asia and the Caucasus outperform their neighbors economically?

While much of the literature on post-communist transitions focuses on broader patterns, like diffusion from the West, regional divergences in places like Central Asia and the Caucasus remain less researched. This paper highlights the underexplored intra-regional variations in economic development in the post-communist space. Central Asia and the Caucasus are particularly relevant for this analysis, as both regions play very important roles in energy supply and the facilitation of trade routes. Understanding why some of these states advanced more quickly than others can help shed light on how institutional design, political choices, and natural resource governance shape economic trajectories. In doing so, this paper contributes to the ongoing discourse on postcommunist transitions—especially where they diverge from standard models of third wave democratization—and emphasizes the need to move beyond Eurocentric explanations of post-Soviet development.[2]

Background

Following the dissolution of the Soviet Union, the newly independent post-communist states faced a period of substantial change and uncertainty. Under the Soviet Union's centralized, one-party system, the government had tightly controlled nearly every aspect of economic and political life through central planning. With the collapse of that system, 15 republics—along with other former Soviet-aligned states—were suddenly left to navigate independence without the institutional support or structure they had relied on for years.

[2] Michael McFaul, "The Fourth Wave of Democracy and Dictatorship: Noncooperative Transitions in the Postcommunist World," *World Politics* 54, no. 2 (2002): 236.

The transition away from communism was therefore turbulent for most countries. Economically, many countries faced chaos, marked by soaring inflation, rising unemployment, and the collapse of state-run industries.[3] Politically, instability was widespread as nations struggled to establish new systems of governance. There was no uniform path forward: some states embraced rapid market reforms and the wave of democracy that was occurring around the world, while others opted for a slower, more cautious transition or reverted to authoritarian models of governance. What became clear over time is that the choices made during this critical period had lasting consequences. The varying degrees of reform, external support, and institutional capacity shaped each country's developmental trajectory, particularly in regions with limited Western engagement or support.

Western influence and support played a significant role in shaping post-communist transitions. CEE countries, due to their geographical proximity to the West, immediately attracted far greater interest and investment than nations in Central Asia and the Caucasus. This interest was driven not only by strategic considerations but also by Cold War-era fears, such as the domino theory, an idea popularized by President Dwight D. Eisenhower in the 1950s, which suggested that a regression to communism in one country could trigger a broader regional backslide. In response, Western powers actively sought to offer CEE countries an alternative path.

At first glance, CEE countries' further development post 1991 appears to be a function of geography, however, this ultimately served as a proxy for political and economic inclusion. CEE states were not only provided with substantial economic assistance but were also often offered the prospect of integration into Western institutions such as the European Union (EU) and the

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[3] John. E. Elliot and Abu F. Dowlah, "Transition Crises in the Post Soviet Era," *Journal of Economic Issues* 27, no. 2 (1993): 527.

North Atlantic Treaty Organization (NATO). These opportunities enabled them to stabilize internal politics much quicker, suppress potential internal conflicts, and access Western markets. These advantages were largely unavailable to their counterparts in Central Asia and the Caucasus in the immediate aftermath of the collapse of the Soviet Union.

This dynamic was also evident in Central Asia and the Caucasus, where both economic and political chaos followed the collapse of the Soviet Union. These regions had operated under the centralized planning and state ownership of the Soviet Union for decades, making them especially vulnerable to the collapse of the system. They were often more deeply embedded in the Soviet system than CEE countries, which had not been fully integrated into the Soviet Union as republics. Their economies were heavily integrated into the Soviet structure and had severely underdeveloped private sectors, leaving them ill-prepared to function independently. Whereas the CEE states benefited from substantial Western support during their transitions, countries in Central Asia and the Caucasus began from much more fragile political and economic positions.

In Central Asia, the five post-communist republics—Kazakhstan, Kyrgyzstan, Uzbekistan, Turkmenistan, and Tajikistan—faced similarly daunting challenges. Most adopted authoritarian political systems to varying degrees. Kyrgyzstan has struggled with frequent protests and governmental changes; despite being the first democratic republic to emerge in the region, they have been moving back towards authoritarianism.[4] Uzbekistan maintained a rigid authoritarian model under President Islam Karimov until the 2010s, and has since seen increased reform and liberalization, though control by the government over opposition remains tight.[5] Turkmenistan pursued extreme isolationism and, as of 2020, has appeared to institute dynastic rule with power being passed from President Gurbanguly Berdimukhamedov to his son Serdar

[4] Richard Pomfret, *The Central Asian Economies in the Twenty-First Century: Pacing a New Silk Road* (Princeton University Press, 2019), 162.
[5] Ibid, 96.

Berdimuhamedow.[6] Tajikistan has remained relatively politically stable under President Emomali Rahmon since 1994 however, his authoritarian practices are a consequence of this.[7] It seems likely that he will install his son as his successor, mirroring the dynastic rule that has been implemented in Turkmenistan. Despite the turmoil experienced in this region, Kazakhstan stands as a relative outlier. Although it has remained authoritarian under the guise of a democratic system, it managed to attract substantial foreign investment by leveraging its natural resources early in the transition. This helped the country to stabilize its government and invest in long-term infrastructure development.

In the Caucasus, Armenia, Georgia, and Azerbaijan all faced violent conflict and political upheaval that significantly complicated their transitions. Armenia and Azerbaijan were drawn into a full-scale war over the disputed region of Nagorno-Karabakh shortly after the Soviet collapse. What had once been an internal Soviet territorial dispute became a high-stakes international conflict. As a result, Armenia closed its borders to Azerbaijan and Turkey, leading to economic isolation in the region that has stunted its growth.[8] In contrast, Azerbaijan experienced a far more stable political transition, though not toward democracy, but rather toward a more entrenched form of authoritarianism. They have capitalized on their oil wealth to pursue a state-led, resource-based economy. The surge in global oil prices during the 2000s enabled substantial investment in infrastructure and international partnerships, setting Azerbaijan apart from its neighbors. Georgia, though not involved in the Nagorno-Karabakh conflict, experienced a civil war including conflicts in Abkhazia and South Ossetia, and ongoing political

[6] Ibid, 126.
[7] Lena Jonson, Tajikistan in the New Central Asia (I.B. Tauris, 2006), 52.
[8] Thomas de Waal and Anna Matveeva, *Central Asia and the Caucasus: A Vulnerable Crescent* (International Peace Institute, 2007), 3.

instability into the 2000s.[9] While the country has made significant strides toward liberalizing its economy, progress has been slowed by political divisions and institutional fragility.

What unites Central Asia and the Caucasus is a shared baseline: authoritarian-leaning political systems, low initial institutional capacity, and minimal influence and engagement from the West. What distinguishes the countries within these regions—and what this paper aims to explore—are the ways in which certain postcommunist countries were able to leverage specific advantages, such as natural resource wealth, to implement policies that drove economic growth. Despite being situated in challenging regional contexts, a few countries managed to mitigate their disadvantages by attracting foreign investment and building state capacity around resource-driven growth, which mimicked the support CEE countries received from the West since 1991.

Literature Review:

After the dissolution of the Soviet Union in 1991 and the subsequent era of transition for postcommunist states, scholars in the field of political science have sought to understand the divergences in economic development these countries experienced. Starting with very similar conditions—facing economic hardship and political instability—the states of post-communism were in very contrasting situations just ten years later. Scholars have reached varying conclusions when trying to explain these different outcomes. One branch of the literature on this topic focuses on path-dependent explanations, which refer to past actions that significantly influence future conditions. Kitschelt (1999) convincingly argues this variance can be attributed more specifically to those states that had a strong tradition of rule of law pre-communism.[10] In

[9] Ibid, 3.
[10] Herbert Kitschelt, Zdenka Mansfeldova, Radoslaw Markowski, and Gábor Tóka, *Post-Communist Party Systems: Competition, Representation, and Inter-Party Cooperation* (Cambridge University Press, 1999), 2.

countries where that was the case, he argues their transition from communism did not uproot everything they knew but rather returned them to their prior status quo. Similarly, Fish (1998) also emphasizes a path-dependent explanation, however, he highlights a different variable as the cause. He argues instead that these differences can be explained by the outcome of the first election after the dissolution of the Soviet Union.[11]

Another plausible explanation is presented by Hellman (1998). He argues these divergences are better explained by examining the extent to which reforms were truly implemented in postcommunist states where democratic transitions were attempted. Whereas there is typically an emphasis on the "short-term" losers of market reform, in the case of postcommunism, the concern was "restraining the winners."[12] Even in states where power was immediately turned over to the opposition and away from communism, elites shared the same tendencies to protect their interests first. In this, Hellman argues that the key to understanding how these states ended up in such different places politically and economically is the extent to which and how quickly reforms were put into place.

Kopstein (2000), despite finding these ideas persuasive, argues that geographic diffusion is the most crucial variable.[13] Theories that ignore the influence of location are wrong in overlooking it as it must be considered. He argues that there is a strong connection between economic development and proximity to Western Europe which helps to explain why postcommunist countries progressed at different rates. In the years following the dissolution, Eastern Europe significantly outperformed the other postcommunist states, which was apparent as early as 1995 in some cases. Countries closest to Western Europe received the most support

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[11] M. Steven Fish, "The Determinants of Economic Reform in the Post-Communist World," *East European Politics and Societies* 12, no, 1 (1998): 17.
[12] Joel S. Hellman, "Winners Take All: The Politics of Partial Reform in Postcommunist Transitions," *World Politics* 50, no. 2 (1998): 205.
[13] Kopstein and Reilly, "Geographic Diffusion," 13.

and influence from those democratic countries which is something that Kopstein argues has a significant effect and which other scholars tend to overlook.[14] Although other ideas like those of Fish and Hellman are convincing, he argues that interactions between countries—which allowed ideas, resources, and more to be exchanged—are the key to understanding the differences we see in postcommunist states today.

Bunce (2006) echoes Kopstein's ideas on geographic diffusion; she argues that internal factors are not enough to explain the development of postcommunist states and highlights the spread of democratic norms as key to understanding their divergences.[15] Beyond diffusion from Western Europe, diffusion also occurred between postcommunist states. Successful revolutions in one country set examples for neighboring countries and these reforms were looked to as models for politics and economy.

McFaul (2002) suggests an alternative idea to geographic diffusion and path-dependent explanations. To assess the divergences between countries he examines the balance of power that emerged in each country after the dissolution of the Soviet Union.[16] Many different types of transitions occurred, some "cooperative" and some "noncooperative." Democratic outcomes were typically associated with cooperative outcomes and authoritarian with noncooperative. However, there were also cases in which noncooperative transitions resulted in democracy or partial democracy. In searching for explanations other than geographic diffusion in cases where it does not apply, McFaul makes interesting and compelling points to consider.

Although there has been substantial research conducted on how these divergences can be explained, the question of how we can explain regional divergences is still left unanswered.

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[14] Ibid, 2.
[15] Bunce, Valeria J., and Sharon L. Wolchick. "International diffusion and postcommunist electoral revolutions." *Communist and Post-Communist Studies* 37 no. 3 (2006): 287.
[16] McFaul, "The Fourth Wave of Democracy and Dictatorship," 220.

Kopstein's ideas of geographic diffusion explain why countries in Eastern Europe are doing better than those in Asia, however, his ideas cannot explain outliers that emerge within regions. For countries that share the same geographic location, diffusion cannot explain why one did better than the other. Therefore, we still need to account for differences within regions that share similar levels of diffusion from Western Europe.

As is very clear, after the dissolution of the Soviet Union, the Russian Federation and the rest of Central and Eastern Europe experienced the most growth and to this day remain the most economically developed. This divergence from other postcommunist states is explained by Kopstein's ideas of geographic diffusion; those countries in proximity to Western Europe received significantly more support than those in Asia. As the emergence of communism in Central and Eastern Europe was a direct threat to Western Europe, it was in their best interest to provide the support necessary to contain it. What his ideas on diffusion cannot explain are the differences in economic development within certain regions. According to the theory of geographic diffusion referenced by Kopstein (2000) and similar ideas by Bunce (2006), countries sharing similar geographic locations should in theory share ideas through "cross-border interactions" and receive similar levels of support due to their shared distance from Western Europe.[17] Within regions like the Caucuses—where Azerbaijan began to outperform both Armenia and Georgia in terms of economic development as early as 2000—or the Central Asian Republics—where Kazakhstan had significantly more growth than Uzbekistan, Turkmenistan, Kyrgyzstan, and Tajikistan—the theory of geographic diffusion does not apply. Despite their similarities in terms of geographical location, these outliers begin to surpass their counterparts'

[17] Kopstein and Reilly "Geographic Diffusion," 6.

economic development (in terms of GDP).[18] This particular set of divergent circumstances requires more research, as it is not considered in much of the literature on this topic.

Research Design:

To investigate the research question—how can we explain regional divergences in postcommunist countries—this paper employs a comparative case study design. Azerbaijan and Kazakhstan were selected as good examples of regional economic outliers, having significantly outperformed their neighbors in terms of economic development post-1991. Despite substantial differences in geography, size, proximity to Russia, and religion, both countries display similar economic trajectories, making them an ideal example aimed at isolating the stronger variable at play. Concentrating on these outliers allows us to illustrate what could be driving them to deviate from the expectations of the region.

The paper focuses on two key indicators of economic divergence: gross domestic product (GDP) and total energy production, both central to understanding economic development in postcommunist resource-rich states. GDP data has been sourced from the World Integrated Trade Solution (WITS), maintained by the World Bank, and energy data from the U.S. Energy Information Administration (EIA). Information on Foreign Direct Investment (FDI) was also provided by the World Bank Group. The dataset covers the period from 1991 to the present, capturing the full scope of the postcommunist transition.

This research, therefore, is mainly qualitative, however, it also adopts a mixed methods approach. The quantitative component involves comparing trends in GDP, energy production, and FDI over time between case study countries and their respective regions to identify

[18] "GDP by Country," WITS Data, accessed April 7, 2025. https://wits.worldbank.org/CountryProfile/en/country/by-country/startyear/ltst/endyear/ltst/indicator/NY-GDP-MKTP-CD

measurable patterns of economic divergence. The qualitative component draws on existing academic literature on postcommunist transitions and the political economy of the Caspian Sea region to analyze institutional reforms, policy decisions, and structural conditions that may account for observed outcomes. This demonstrates how numerical data reflects or responds to changes in policy reforms and fluctuations in foreign engagement.

An observational research strategy is used, as the goal is to identify and interpret relationships rather than to conduct experimental or causal testing. By comparing economic performance, political-economic reforms, and foreign intervention across countries, this research seeks to uncover the variables most strongly associated with regional economic divergence. Ultimately, this design allows for a more comprehensive understanding of why Kazakhstan and Azerbaijan have diverged economically from their regional peers, and how their paths compare to broader trends in the postcommunist world.

Analysis

Kazakhstan

Following the collapse of the Soviet Union in 1991, Kazakhstan faced particularly difficult conditions. Relative to its neighbors, Kazakhstan had an unproductive economy, and, as the last republic to declare independence from the Soviet Union on December 6th, 1991, experienced a severe economic downturn.[19] Under President Nursultan Nazarbayev—who assumed leadership in 1990 while Kazakhstan was still a Soviet Republic—the country quickly shifted its focus toward building an economy that benefited its own population rather than the centralized Soviet system.[20]

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[19] Yelena Kalyuzhnova, *Economics of the Caspian Oil and Gas Wealth* (Palgrave Macmillan, 2008), 35.
[20] Christopher Hartwell, *Snow Leopard at the Crossroads* (Routledge, 2023), 217.

Despite possessing significant natural resources, especially in the hydrocarbon sector, Kazakhstan lacked the necessary technology or financial capital to effectively exploit them. The Soviet system had left the country underdeveloped, with its economy primarily oriented toward agriculture and livestock farming.[21] In contrast, the Central and Eastern European (CEE) countries received immediate support and investment from Western nations following the collapse of the Soviet Union, which helped them rebuild their economies and infrastructure and prevented the re-emergence of communism. This disparity is clearly illustrated in Figure 1, which shows GDP by region from 1988 to 2022.

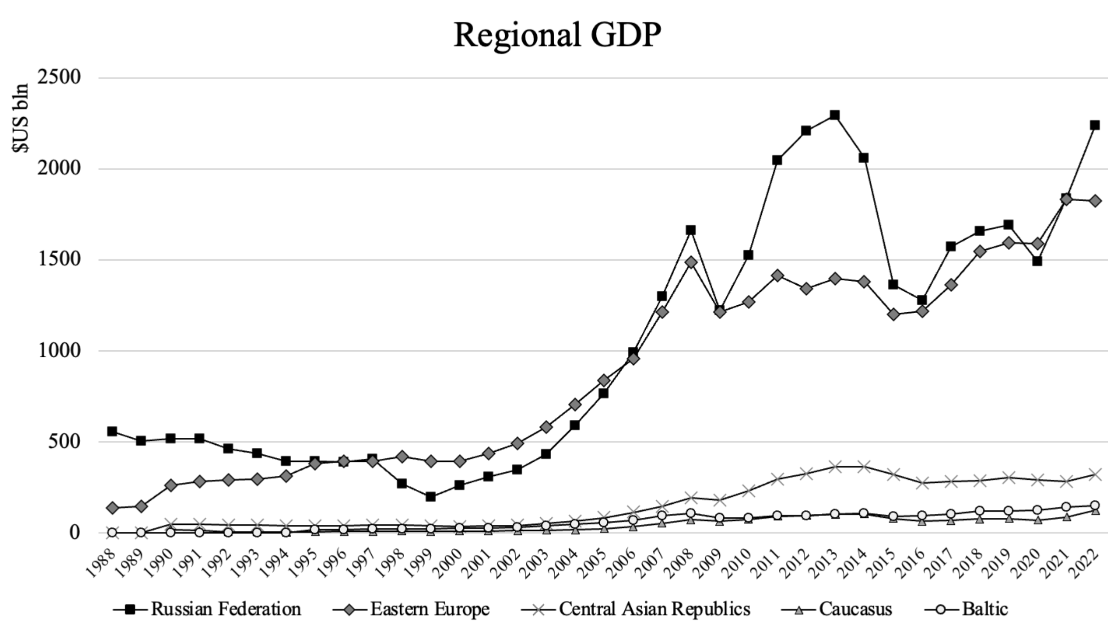

Figure 1. Regional GDPs post-communism, 1988-2022
Source: WITS Data. "GDP by Country." Accessed April 7, 2025. https://wits.worldbank.org/CountryProfile/en/country/by-country/startyear/ltst/endyear/ltst/indicator/NY-GDP-MKTP-CD

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[21] Gaël Raballand and Régis Genté, "Oil in the Caspian Basin: Facts and Figures," in *The Economics and Politics of Oil in the Caspian Basin,* ed. Boria Najman, Richard Pomfret, and Gaël Raballand (Routledge, 2008), 10.

To address these economic challenges, Nazarbayev adopted an "economics first, politics later" approach, prioritizing the rapid transformation of the economy over political reform.[22] The idea was that strong economic institutions would gradually steer the country away from centralized politics. This strategy proved ineffective in fostering political change, as Nazarbayev instead centralized power and remained in office until 2017.[23] Despite the emergence of certain authoritarian tendencies, the economic reforms implemented under his leadership were carried out relatively smoothly compared to those in neighboring countries. As a result, Kazakhstan was able to achieve notable economic development by the early 2000s.

One of the first major economic reforms in Kazakhstan was price liberalization, intended to rapidly reintroduce market mechanisms. As early as January 1992, 80% of prices were freed from state control.[24] While the goal was to break away from the Soviet system of fixed prices, this move triggered a wave of macroeconomic instability, resulting in severe hyperinflation.[25] Compounding the issue, Kazakhstan lacked an independent monetary policy and remained closely tied to Russia's central bank. As a result, the National Bank of Kazakhstan (NBK) was unable to fully control the money supply or manage the inflation they were experiencing.[26] Since Russia continued to issue credit, its economic problems spilled over into Kazakhstan, further destabilizing the economy.[27]

Despite these negative consequences, Kazakhstan delayed its exit from the Ruble Zone until 1993. When the new currency—the Tenge—was introduced, the NBK continued its previous practice of issuing cheap credit, which undermined the stability of the new currency.

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[22] Hartwell, *Kazakhstan*, 218.
[23] Pomfret, *The Central Asian Economies*, 73.
[24] Christopher Hartwell, *Snow Leopard at the Crossroads* (Routledge, 2023), 221.
[25] Kalyuzhnova, *Economics of the Caspian,* 36.
[26] Pomfret, *The Central Asian Economies*, 70.
[27] Kalyuzhnova, *Economics of the Caspian,* 36.

Within the first year, the Tenge lost over 85% of its value.[28] It was not until 1996 that inflation was brought under control and price liberalization was completed. As shown in Figure 2, by 1995 Kazakhstan's GDP had fallen from $26 million to $20 million—below its 1989 GDP level.[29] In contrast, Poland had already surpassed its 1989 GDP level. Given these circumstances, the strong post-2000s economic growth seen in Kazakhstan was unexpected. By all accounts, the region should have maintained economically stagnant, but Kazakhstan defied expectations, making it a notable outlier.

Figure 2. GDP by Country in Central Asia, 1988-2022
Source: WITS Data. "GDP by Country." Accessed April 7, 2025. https://wits.worldbank.org/CountryProfile/en/country/by-country/startyear/ltst/endyear/ltst/indicator/NY-GDP-MKTP-CD.

Kazakhstan's significant economic contraction in the 1990s highlighted the inefficiencies of the Soviet centralized economy and underscored the need to further separate from Russian

[28] Hartwell, *Kazakhstan*, 226.
[29] WITS Data, "GDP by Country."

markets. After 1993, the country aggressively pursued the development of a capitalist financial system to restore stability. The NBK led a series of banking reforms, adopted institutional banking standards, and established debt resolution institutions.[30] By the late 1990s, growth was small but evidence and the country was largely stable. This shift encouraged foreign direct investment (FDI) which supported continued economic and infrastructural development, and was reflected in rising GDP and energy production from the early 2000s onward. FDI, energy production, and GDP are closely related variables. Since 2001, annual FDI to Kazakhstan has exceeded $1 billion per year.[31] Most of this, at least 85% during the critical early years of the 2000s and around 60% today, is directed toward the hydrocarbon sector.[32]

A positive feedback loop existed between FDI, GDP, and hydrocarbon production, where growth in one area reinforces growth in the others. Economic stability and proven hydrocarbon reserves attract FDI by signaling both profitability and resource potential. In turn FDI enhances production through an initial capital investment and the subsequent development of infrastructure, which boosts GDP. Rising GDP further stabilizes the economy, attracting even more FDI and creating a self-reinforcing cycle of economic growth. While other Central Asian republics also possessed natural resources that could have supported similar development, political instability in many of these states hindered the possibility of attracting substantial FDI, the critical first step in building a hydrocarbon-based economy in the Caspian region during the postcommunist transition.

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[30] Hartwell, *Kazakhstan*, 253.
[31] "Foreign Direct Investment Net Flows," World Bank Group, accessed June 1, 2025, https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD
[32] Raballand and Genté, "Oil in the Caspian Basin," 14.

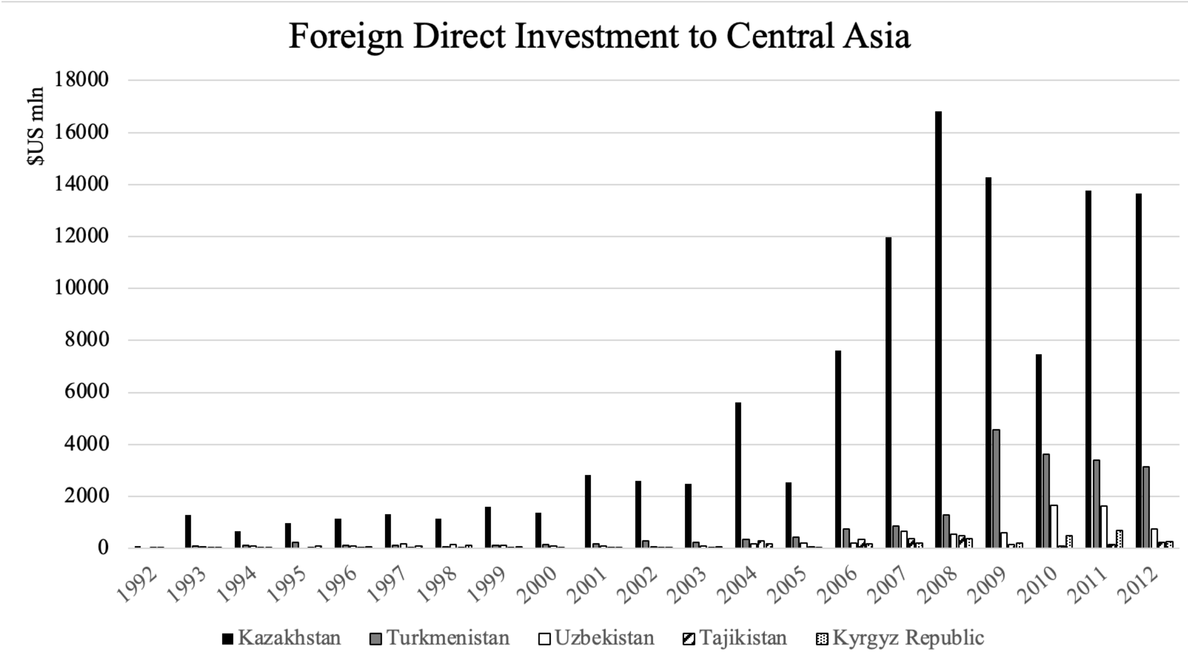

Figure 3: Foreign Direct Investment to Central Asia, 1992-2012
Source: World Bank Group. "Foreign Direct Investment Net Flows." Accessed June 1, 2025. https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD.

Although FDI remained relatively low in the late 1990s compared to the levels it would reach in the early 2000s (as shown in Figure 3), it was sufficient for Kazakhstan to continue exploring and developing its natural resources. By the early 2000s, the country had significantly expanded its proven hydrocarbon reserves. This was largely due to two key developments: the discovery of oil at Kashagan in 2000 and the opening of the Caspian Pipeline Consortium (CPC) pipeline, which connected the Tengiz, Kazakhstan's largest oilfield, to the Russian port of Novorossiysk.[33] As shown in Figure 4, energy production in 2000 reached nearly 4 quadrillion British Thermal Units (BTU), a substantial increase from 3 quadrillion BTU in 1999.[34] These developments were strongly supported by the government; in April 2000, President Nazarbayev

[33] Ibid.
[34] "Primary Energy," US Energy and Information Administration, accessed May 1, 2025, https://www.eia.gov/international/data/world/total-energy/total-energy-production.

declared, “We think that by 2015 we shall be producing 400 million tons per year, or about the same as Saudi Arabia.” [35]

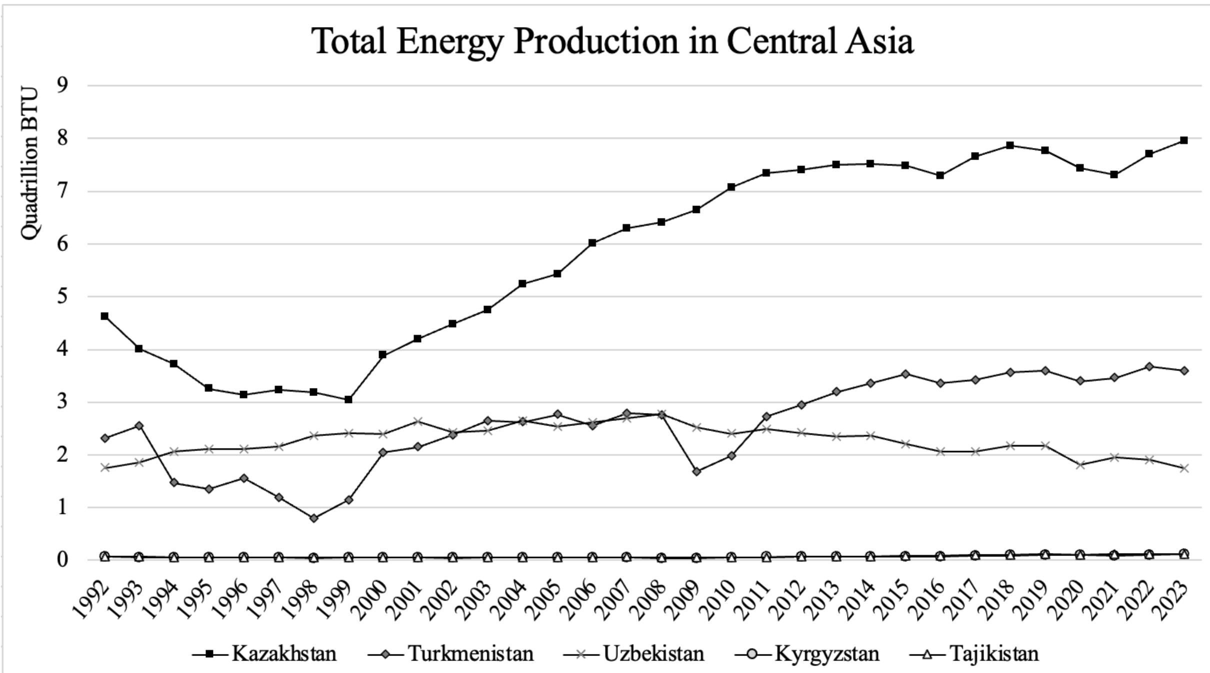

Figure 4. Total Energy Production in Central Asia, 1992-2023
Source: US Energy and Information Administration. “Primary Energy.” Accessed May 1, 2025. https://www.eia.gov/international/data/world/total-energy/total-energy-production

Although Nazarbayev’s prediction did not materialize—with the entire Caspian Sea region producing less than 50% of Saudi Arabia’s output—the strong support from government institutions was crucial in driving Kazakhstan’s economic transformation and integrating it into the global market.[36] Stable political institutions not only signaled to foreign investors that Kazakhstan’s hydrocarbon sector was a safe and promising investment, but they also played a key role in shaping economic policy and identifying the best strategies to increase national wealth. In contrast, countries with unstable political leadership often appear unreliable and are

[35] John Roberts, “Energy Reserves, pipeline routes, and the legal regime in the Caspian Sea,” in *The Security of the Caspian Sea Region,* ed. Gennady Chufrin (Oxford University Press, 2001), 37.
[36] Raballand and Genté, “Oil in the Caspian Basin,” 16

far less capable of enacting and maintaining effective reforms. Frequent changes in government make it difficult to implement, monitor and sustain long term policy. Despite Nazaerbayev's authoritarian tendencies, the political stability he provided helped attract FDI to Kazakhstan's hydrocarbon sector. This stability allowed for consistent economic reforms throughout the 1990s, laying the foundation for the country's economic success in the early 2000s. As shown in Figures 2 & 4, both energy production and GDP follow a parallel upward trend after 2000. The key distinction is that while many countries in the region had access to natural resources—Turkmenistan, for example, produced only 1 quadrillion BTU less than Kazakhstan in the early 1990s—those resources could not be fully leveraged without first achieving political and economic stability. It wasn't until the late 1990s, when FDI began to increase significantly, that hydrocarbon production truly accelerated.

A clear pattern emerges: while CEE countries received immediate political and economic support from Western nations following the collapse of the Soviet Union, foreign investment in Central Asia lagged behind by several years. CEE countries, such as Poland and the Czech Republic, were quickly integrated into Western institutions like the EU and NATO, gaining access to markets, funding, and governance frameworks that accelerated their development almost immediately. In contrast, Central Asia's more authoritarian political environments and less open markets initially discouraged foreign investors, as these countries needed to resolve internal challenges before attracting serious international attention. Although the FDI that eventually flowed into Central Asia was neither as extensive nor as coordinated as the support provided to CEE countries, it nonetheless echoed similar patterns: directing capital into strategic sectors like energy and infrastructure. Among the Central Asian republics, Kazakhstan stood out due to its cast hydrocarbon reserves and comparatively more open economic and political environment. It attracted substantial FDI, particularly from Western oil companies and later from Chinese state enterprises, positioning itself as the region's economic leader.

This divergence in the timing and volume of FDI contributed to a widening development gap. Kazakhstan's early embrace of FDI helped finance the construction of its capital city, diversify its economy, and modernize key sectors like energy and infrastructure. This set it apart from more insular neighbors like Uzbekistan and Turkmenistan. In this sense, Kazakhstan's development trajectory within Central Asia echoes the broader divide between CEE countries and other postcommunist states: those that received early and sustained Western engagement advanced more rapidly in both economic and institutional terms. However, it is important to recognize that while FDI played a crucial role, it was not a full solution. Persistent issues such as corruption, a lack of democratic reforms, and an overreliance on natural resources continue to shape Kazakhstan's long-term prospects. These challenges illustrate that while the timing and scale of FDI mattered, domestic political choices were also significant.[37]
Kazakhstan did not gain access to the full range of developmental opportunities offered to CEE countries. They were able to join Western institutions and integrate more fully, which helps to explain why Kazakhstan was never able to catch up to CEE countries on the same scale.

Azerbaijan

Following the dissolution of the Soviet Union in 1991, Azerbaijan—like most non-CEE postcommunist states—faced difficult initial conditions. Prior to independence, the country experienced violent suppression of anti-Soviet demonstrations in its capital, Baku, more commonly referred to as Black January.[38] As unrest spread throughout the Soviet republics in the

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[37] Kalyuzhnova, *Economics of the Caspian,* 14.
[38] Astrid S. Tuminez, "Nationalism, Ethnic Pressures, and the Breakup of the Soviet Union," *Journal of Cold War Studies* 5, no. 4 (2003): 117

early 1990s, such crackdowns represented desperate attempts to maintain the Soviet Union's cohesion. Furthermore, Azerbaijan was involved in the escalating Nagorno-Karabakh conflict with Armenia, which intensified after the Caucasus republics declared independence and developed into a full-scale war.[39] These factors, along with the abrupt transitions to a market economy, triggered a period of hyperinflation that lasted from 1991 to 1994.[40] Despite these serious pre-existing issues, newly elected President Abulfaz Elchibey prioritized economic reform when he took power in 1992. A former leader of the non-communist People's Front of Azerbaijan (PFA), Elchibey marked a dramatic shift in political leadership following decades of communist rule.[41] Recognizing the potential of Azerbaijan's hydrocarbon resources to fuel economic development, he made oil and gas exploration a national priority. As early as 1992, the initial framework for a foreign oil deal was already being drafted.[42]

Economic and political challenges were significantly more complex in Azerbaijan than in Kazakhstan. Following a Russian-backed coup led by Colonel Surat Huseynov, Elchibey stepped down in 1993 to prevent further political chaos, and Heydar Aliyev assumed power.[43] Initially, there were concerns about Aliyev's leadership, as he was a Soviet-era politician and former head of the Communist Party of Azerbaijan, raising questions about if he would prioritize Russian interests over those of the country. However, in a somewhat unexpected turn, Aliyev adopted a stance similar to that of Elchibey and the PFA regarding the hydrocarbon sector and the economy. He continued to advance the oil deal, albeit with revisions that included Russian involvement.[44] This shift in power did, however, reflect a broader regional pattern of former

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[39] de Waal and Matveeva, *Central Asia and the Caucasus,* 3.
[40] International Monetary Fund, "Azerbaijan: Recent Economic Developments," *International Monetary Fund 1995,* no. 119 (1995): 22.
[41] Swietochowski, "The Politics of Oil," 124.
[42] Bagirov, "Azerbaijan's strategic choice," 180.
[43] Kalyuzhnova, *Economics of the Caspian,* 38.
[44] Sabit Bagirov, "Azerbaijan's strategic choice in the Caspian region," in *The Security of the Caspian Sea Region,* ed. Gennady Chufrin (Oxford University Press, 2001), 179.

Soviet leaders returning to power, which was Russia's attempt to reassert dominance in the region.[45] In many postcommunist states this resurgence of old leadership and structure stalled economic growth. However, Aliyev's continued commitment to the development of the hydrocarbon sector and efforts to steer the economy away from Russian dependence set Azerbaijan apart.

Azerbaijan and its economy remained highly unstable in the early 1990s, as the turmoil of the Nagorno-Karabakh war prevented the structured implementation of reforms like those of Kazakhstan.[46] In response to this severe economic crisis, Aliyev pursued a more gradual reform approach that prioritized stabilization over rapid transformation. One of the earliest measures implemented was price liberalization, which began in 1992 as Soviet-era price controls collapsed.[47] Like in other postcommunist states, this reform aimed to dismantle the planned economy and facilitate the transition to a market based economy. However, without adequate institutional support, price liberalization triggered a sharp increase in prices, intensifying the already severe hyperinflation. This situation was worsened by Azerbaijan's continued dependence on the Russian ruble and its lack of an independent monetary policy. The Central Bank of Azerbaijan (CBA) was underdeveloped and struggled to manage inflationary pressures effectively.[48]

Despite the mounting economic challenges and the clear need to distance itself from Russia, Azerbaijan remained in the ruble zone until late 1993.[49] It was no longer sustainable, and they were essentially forced out. Although the new national currency, the Manat, had been introduced in 1922, it remained largely ineffective until 1994, when the ruble was fully phased

[45] Swietochowski, "The Politics of Oil," 125.
[46] Alex Marshall, *The Caucasus Under Soviet Rule* (Routledge, 2010), 284.
[47] International Monetary Fund, "Azerbaijan," 34.
[48] Ibid, 2.
[49] Audrey L. Altstadt, "Azerbaijan: Politics, Society, and Economy Since Independence," in *Routledge Handbook of the Caucasus,* ed. Galina M Yemelianova and Laurence Broers (Routledge, 2020), 167.

out.[50] During this transition, the Manat experienced severe depreciation. Similar to the situation in Kazakhstan, the CBA continued to rely on credit issuance, which undermined price stability and culminated in peak hyperinflation in 1994. It wasn't until 1996, with support from the International Monetary Fund (IMF) and the adoption of banking standards, that inflation began to decline.[51] As shown in Figure 5, by this time GDP had already fallen to roughly 50% below 1989 level and meaningful economic recovery did not begin until the early 2000s, when hydrocarbon development accelerated. Given the severity of Azerbaijan's early economic collapse, its post-2000s growth was unexpectedly strong.

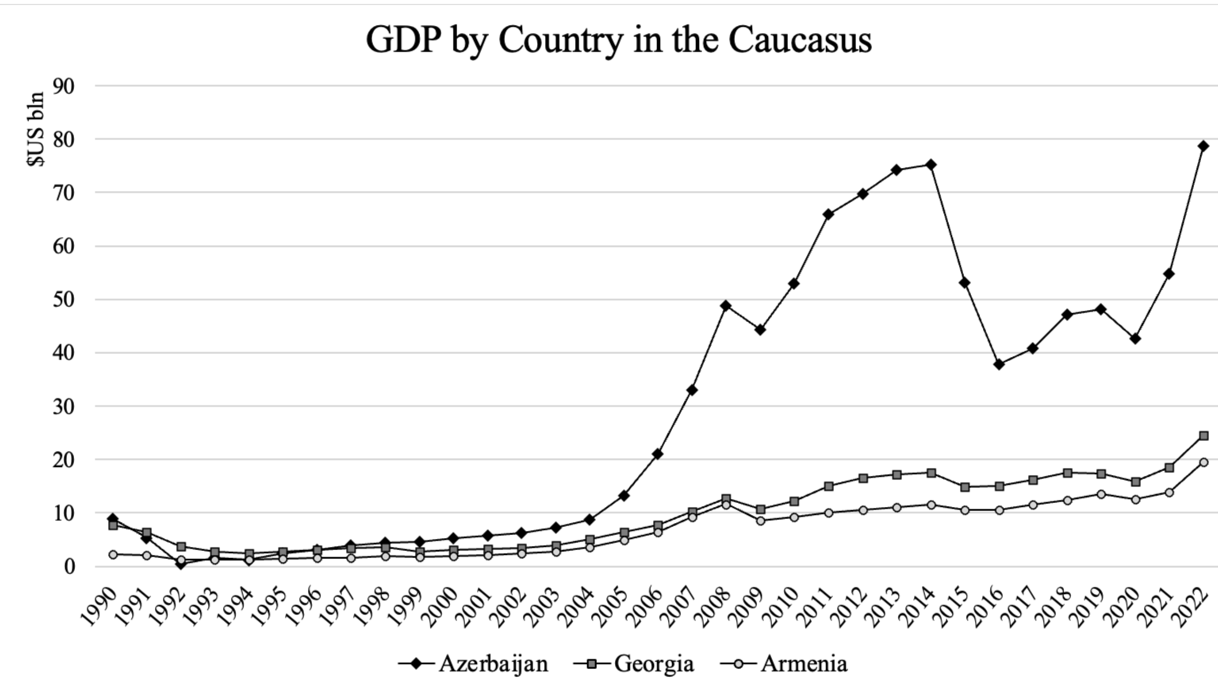

Figure 5. GDP by Country in the Caucasus
Source: WITS Data. "GDP by Country." Accessed April 7, 2025. https://wits.worldbank.org/CountryProfile/en/country/by-country/startyear/ltst/endyear/ltst/indicator/NY-GDP-MKTP-CD.

[50] International Monetary Fund, "Azerbaijan," 1.

[51] International Monetary Fund, "Azerbaijan: Recent Economic Developments," *International Monetary Fund 1998,* no. 98/83 (1995): 11.

Unlike Kazakhstan, which adopted an "economics first, politics later" approach to early economic liberalization, Azerbaijan followed a more cautious and delayed path to market reform, prolonging its period of economic instability. This difference in strategy helps explain the gap in the timing of economic growth between the two countries. Nevertheless, once stabilization policies were introduced in the late 1990s, Azerbaijan began to establish the foundations for long-term development, particularly through foreign investment in its hydrocarbon sector.

Oil extraction had long taken place on Azerbaijan's western coast, as it was one of the Soviet Union's main oil-producing republics.[52] This marks a key distinction from Kazakhstan, which had a much shorter history in natural resource exportation. However, due to underinvestment and lack of development during the Soviet era, Azerbaijan's onshore oil fields were largely depleted by the time of independence.[53] Offshore oil fields became the only viable option, but these required significantly greater capital for exploration and development.[54] In contrast, Kazakhstan's primary oilfield at Tengiz was located onshore, making extraction less capital intensive and logistically simpler. This is another reason why Azerbaijan's increased wealth occurred later, closer to 2005, as opposed to Kazakhstan's earlier increase around 2000. Given the country's weak economy at the time, Azerbaijan lacked the capacity to develop offshore oil fields independently. Nevertheless, the resource potential was clear and began to attract FDI once the political situation stabilized.[55] This influx of FDI—especially prominent in 2002 and 2003, as shown in Figure 6—enabled the development of new technologies and infrastructure, playing a crucial role in shaping Azerbaijan's hydrocarbon sector and broader economy. Without the initial investments made in the mid to late 1990s, Azerbaijan would likely

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[52] Tadeusz Swietochowski, "The Politics of Oil and the Quest for Stability: The Caspian Sea," in *Post Soviet Central Asia*, ed. Touraj Atabaki and John O'Kane (Tauris Academic Studies, 1998), 119.
[53] Swietochowski, "The Politics of Oil," 124.
[54] Kalyuzhnova, *Economics of the Caspian,* 37.
[55] Raballand and Genté, "Oil in the Caspian Basin," 9.

have not been able to enter the self-reinforcing cycle described in the “Kazakhstan” section, and its economy may have stagnated like many of its regional neighbors.

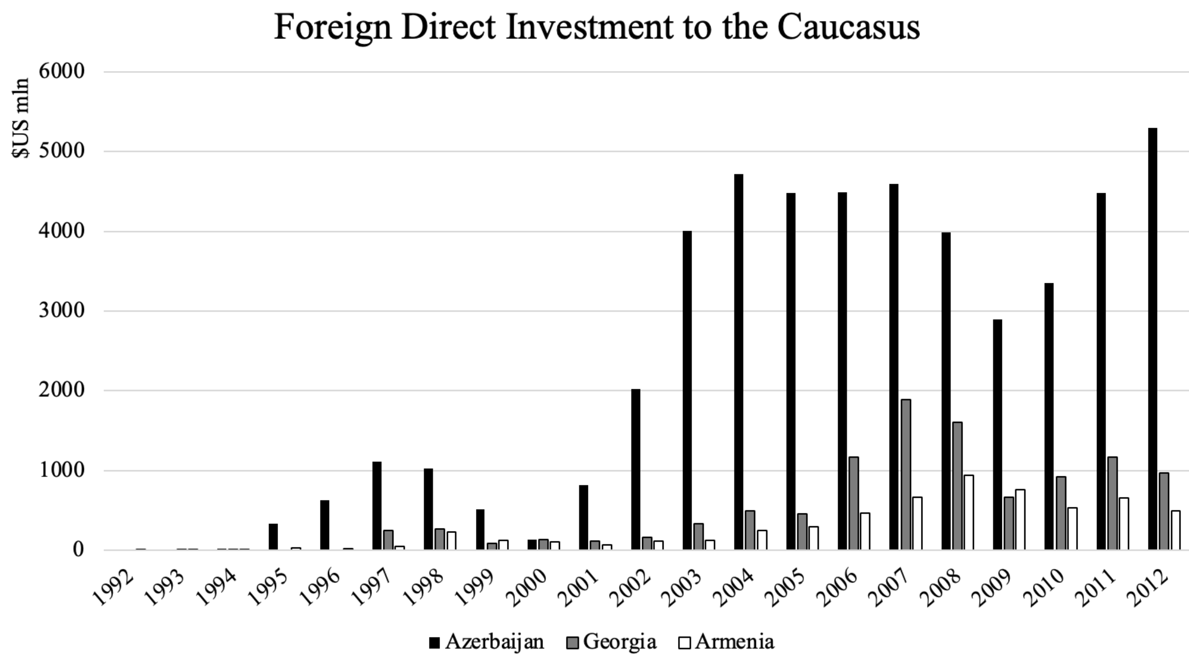

Figure 6. Foreign Direct Investment in the Caucasus, 1992-2012
Source: World Bank Group. “Foreign Direct Investment Net Flows.” Accessed June 1, 2025. https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD.

As early as September 1992, the initial stages of an agreement were reached concerning the development of Azeri oil field and several smaller fields, along with plans for a pipeline linking the Caspian Sea to the Mediterranean coast of Turkey.[56] These developments provoked significant dissatisfaction in Russia, which, despite the formal dissolution of the Soviet Union just a year earlier, still sought to maintain influence over the region. The full oil agreement was eventually signed in Baku on September 20, 1994 and has since become known as the “Contract of the Century.” Covering a 30-year period and valued at over $7 billion, the deal brought together a consortium of international companies including Amoco, Unocal, Pennzoil, and

[56] Bagirov, “Azerbaijan’s strategic choice,” 180.

McDermott from the United States; British Petroleum from Britain; Statoil from Norway; TPAO from Turkey; and Lukoil from Russia.[57] The inclusion of Lukoil at the last minute was likely a move by Aliyev to appease Russian concerns over the legal distribution of Caspian Sea resources, emphasizing his political roots in the former Soviet system. By May 2000, Azerbaijan had signed over 20 contracts with international companies.[58] More recently, the opening of the Baku-Tbilisi-Ceyhan (BTC) pipeline in 2006 has significantly increased Azerbaijan's wealth.[59] The BTC pipeline connects Azerbaijan and Georgia directly to Western markets, allowing Azerbaijani oil to reach global markets without having to go through Russia, further strengthening the country's independence and strategic importance.

Although Azerbaijan never reached the scale of hydrocarbon production seen in countries like Saudi Arabia and even lagged behind Kazakhstan, its transition to a market economy was made possible largely due to state led-stability and the consolidation of power under Aliyev. Amidst a backdrop of war, political upheaval, and economic collapse, Aliyev's leadership provided a degree of political coherence and continuity that was critical for attracting FDI. While Azerbaijan's political system remained largely authoritarian, the regime offered a level of predictability and security, —that many neighboring countries such as Armenia and Georgia lacked—factors that reassured foreign investors and supported the country's economic development.

Azerbaijan's early isolation—driven largely by its deep involvement in the Nagorno-Karabakh conflict—made it an unattractive destination for FDI in the immediate post-Soviet period. Just as Kazakhstan lagged behind CEE countries due to delayed foreign interest during its stabilization phase, Azerbaijan fell even further behind Kazakhstan, as internal

[57] Swietochowski, "The Politics of Oil," 126.
[58] Roberts, "Energy Reserves," 36.
[59] de Waal and Matveeva, *Central Asia and the Caucasus,* 4.

conflict and state fragility postponed both political stabilization and economic liberalization. As a result, Azerbaijan was slower to stabilize, slower to implement reforms and consequently slower to achieve economic development than Kazakhstan. This helps explain the delayed timing of its economic growth and the later onset of large-scale hydrocarbon production (see Figure 7).

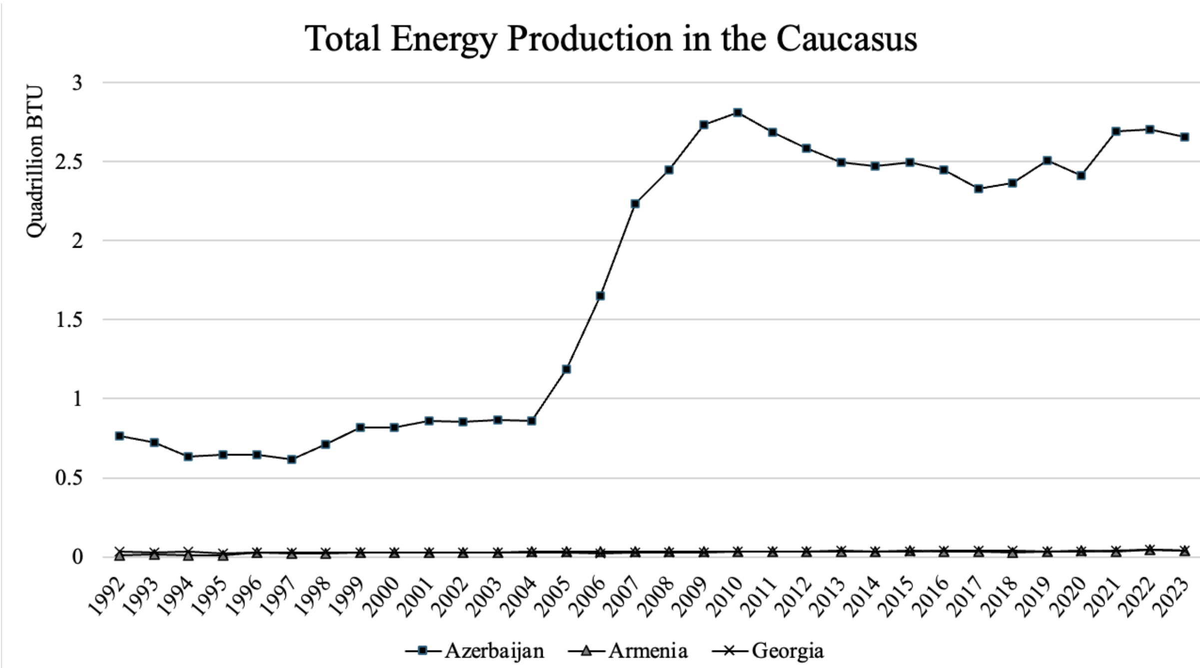

Figure 7. Total Energy Production in the Caucasus, 1992-2023
Source: US Energy and Information Administration. "Primary Energy." Accessed May 1, 2025. https://www.eia.gov/international/data/world/total-energy/total-energy-production

As in the case of Kazakhstan, it is clear that FDI in Azerbaijan also mirrored—albeit on a smaller scale—the kind of support the benefitted CEE countries. Without FDI, Azerbaijan would not have been able to explore its offshore oil fields or develop necessary technology and infrastructure to connect to Western markets. In both countries, FDI was a critical factor that set them apart from their regional neighbors, enabling them to fully capitalize on their natural resource wealth. In this way, FDI functioned as a substitute for broader Western engagement that facilitated successful economic transitions in many CEE states.

Discussion/Conclusion:

Since the early 1990s, Kazakhstan and Azerbaijan have stood out as the only two countries in the Caspian Sea region to emerge as major oil exporters. During their transitions from centrally planned to market economies, the development of the hydrocarbon sector not only provided a foundation for economic growth but also helped shape broader policy reforms.[60] Unlike many non-CEE postcommunist states—which lacked early Western engagement, and consequently, a clear sense of direction in terms of what a market economy would accomplish for them—Kazakhstan and Azerbaijan were able to implement economic reforms more fully because they saw the tangible benefits in the form of FDI and economic growth from doing so. Rising international oil prices in the early 2000s made Caspian oil more valuable, drawing increased FDI and creating a magnifying effect that spurred further exploration and production.[61]

The primary challenge for both countries was to strengthen domestic institutions, attract further investment, and build a functioning market economy. While Kazakhstan was more successful in this regard—benefitting from relative internal stability and access to onshore oil fields—Azerbaijan faced more significant obstacles, including the Nagorno-Karabakh conflict and political upheaval in the early 1990s. As a result, Kazakhstan's economic growth took off earlier around 2000, while Azerbaijan's real growth began closer to 2005 (see Figure 8).

[60] Kalyuzhnova, *Economics of the Caspian,* 17.
[61] Raballand and Genté, "Oil in the Caspian Basin," 16.

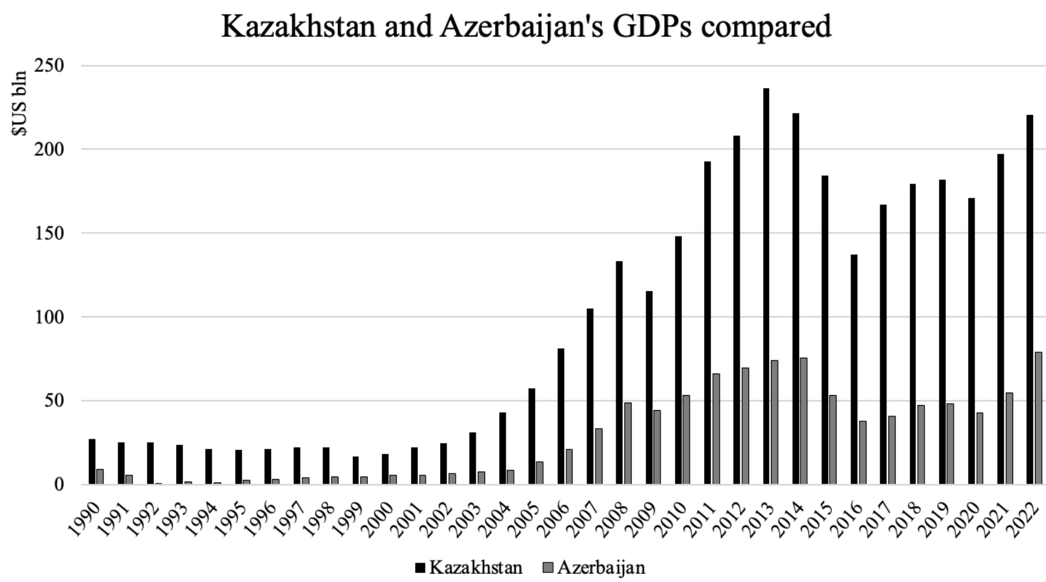

Figure 8. Kazakhstan and Azerbaijan's GDPs compared
Source: WITS Data. "GDP by Country." Accessed April 7, 2025.
https://wits.worldbank.org/CountryProfile/en/country/by-country/startyear/ltst/endyear/ltst/indicator/NY-GDP-MKTP-CD

Turkmenistan is often discussed alongside Kazakhstan and Azerbaijan due to its significant hydrocarbon reserves, yet its trajectory illustrates what might have happened had either of the other two countries failed to stabilize and open up their economies. Despite early potential, Turkmenistan's isolationist policies prevented serious foreign investment during the crucial post-Soviet decade. As shown earlier in Figure 4, its energy production remained stagnant during that period. Only after 2009 did the country begin to attract modest levels of FDI and increase energy production. With access to approximately 6% of the Caspian Sea's oil reserves, Turkmenistan still holds growth potential.[62] However, its delayed engagement underscores the importance of early investment and foreign partnership.

[62] Ibid, 14.

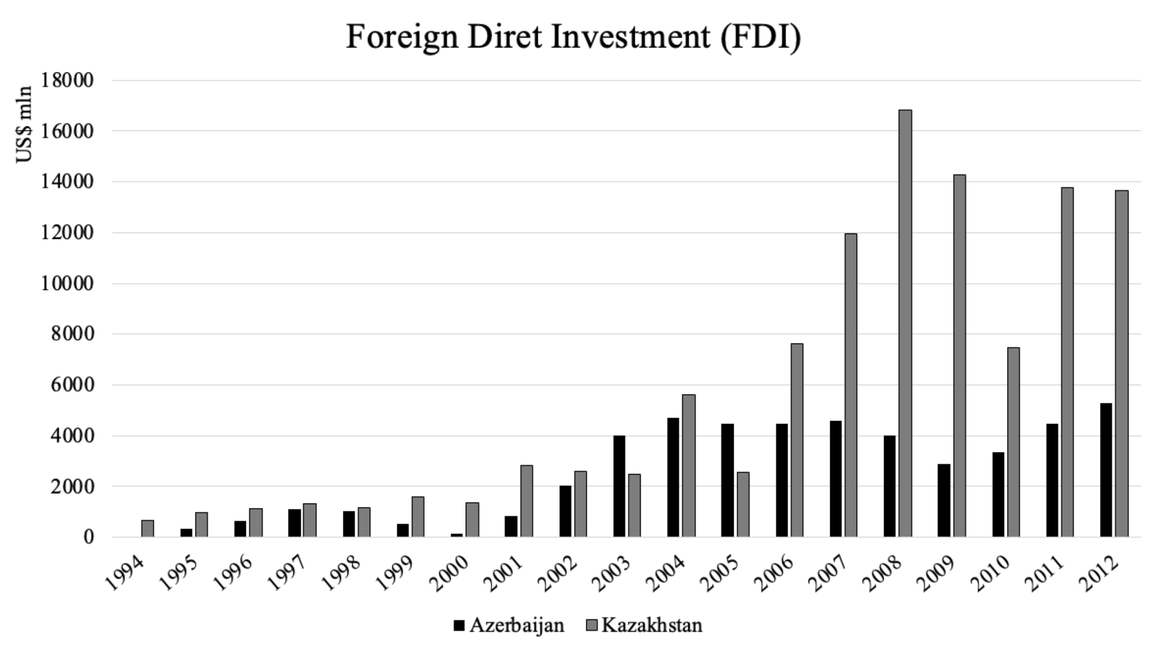

Figure 9. Foreign Direct Investment to Azerbaijan, 1994-2012
Source: World Bank Group. "Foreign Direct Investment Net Flows." Accessed June 1, 2025. https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD.

In both Kazakhstan and Azerbaijan, FDI served a role similar to the early Western support provided to CEE countries, though on a smaller scale. It allowed them to overcome limitations in domestic capacity and take advantage of their resource reserves. Their relative success compared to other postcommunist countries in the region underscores how early political stabilization, coupled with openness to foreign capital, was essential in setting them apart. The differences in their growth—with Kazakhstan pulling ahead earlier and reaching higher levels of GDP, FDI, and energy output—can be attributed to factors such as geographic size, greater hydrocarbon reserves and a more stable early transition.

Yet given Azerbaijan's smaller share of Caspian oil and the internal turmoil it faces, its performance, especially relative to other Cacausus countries, was still notably strong. Ultimately, both countries maximized the opportunities available to them, leveraging their natural resource wealth through foreign partnerships in ways that many of their neighbors did not. Their developmental trajectories reflect the broader lesson that timing, stability, and early external engagement are critical determinants of post-Soviet economic success.

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