CHAPTER-II

ECONOMIC COOPERATION IN CENTRAL ASIA
CHAPTER-II

ECONOMIC COOPERATION IN CENTRAL ASIA

Regional economic cooperation is part of the trend in economic globalization. The appearance and growing importance of such organizations and international trade frameworks as the North American Free Trade Agreement (NAFTA), the Association of South East Asian Nations (ASEAN), and the European Union (EU) among others, indicate the forward movement of economic integration via regionalization. It shall not be an exaggeration to say that participation in some degree of trans-boundary economic integration is necessary for any state or region to compete effectively in today’s global economy. Economists refer to “Zero Sum Games” and “Non-Zero Sum Games”. In a Zero Sum Game, if one person wins, it is because somebody else has lost. In a Non-Zero sum game it is possible for both sides to gain equally. And that is precisely the aim of economic cooperation. However, the challenge is to understand and respect each other’s strategic interests and economic concerns, and to find strategies that allow each government to advance its own interests within the framework of a common programme of action.

This chapter begins with an elaboration of the fallout of the break up of the Soviet Union and then moves on to analytical definition of trade cooperation. While outlining the current economic position in Central Asia, a detailed account of regional trade patterns is presented. The chapter also covers the process of institutionalisation of cooperation efforts in Central Asia in the sphere of economics. Then it deals with a comparative analysis of the declared goals and the real progress made in the past. The reasons of failure in regional economic cooperation will also be put under special scrutiny. An attempt has been made to outline the current economic position in Central Asia by discussing the requirements for regional cooperation and also the prerequisites for future transformation process in the individual Central Asian countries.

Economic cooperation can take many forms. It can mean a simply bilateral trade agreement between two countries on tariffs and trade barriers or a full-scale integration with single currencies, labour markets, and economic policies, as is
taking place in Western Europe. Cooperation on trade issues in Central Asia is defined in this chapter as cooperation in setting intraregional tariff policies and harmonising and coordinating trade facilitation. The United Nations Economic Commission for Europe (UNECE) defines trade facilitation as encompassing ‘the systemic rationalization of procedures and documentation for international trade, where trade procedures are the activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade’.  

There are various types of regional cooperation mechanisms in the sphere of trade. In a free trade area (FTA), trade restrictions among member countries are removed, but each country retains its own tariff structure against outsiders. A customs union entails a free trade area coupled with common external trade policies. A common market is a customs union that also allows for free movement of factors of production. Lastly, an economic union is a common market that includes some degree of harmonisation of national economic policies of member states. The states of Central Asia have primarily engaged in free trade area and customs union initiatives.

Regional groupings and subgroupings which include the Central Asian states can be seen as a part of the general resurgence of regionalism in the post–Soviet international order since the early 1990s. The idea of the subregional structure within the region goes back to the Soviet period. In 1990, the republics of Middle Asia and Kazakhstan, as the region was officially called under the Soviet period, made the first attempt to join hands to improve their domestic situation. For this purpose, an agreement on economic, scientific and technical, and cultural cooperation was signed between the five Central Asian republics. This initiative was necessitated by much-needed strategic changes in the established resource and commodity based orientation of local economies and deteriorating environmental

---

3 Ibid.
conditions, but also to prevent social catastrophes caused by worsening public health, growing child mortality rates, as well as by the unsatisfactory supplies of foodstuffs to local people.

2.1 Fallout of the Soviet Break up

The political and economic collapse of the Soviet Union between 1989 and 1991 was in many ways a historic event of great significance which was unexpected, swift, and socially and economically painful. The transition had two key dimensions. The first was *systemic*, as the political and economic systems changed from dictatorships towards democracy, and from centrally planned to market economies. The second was *spatial*, involving the disintegration of a political and economic space.\(^6\) One of the most striking consequences was the sharp economic decline and the pervasively negative economic impact on most people’s lives. The decline was much deeper and long lasting in the former Soviet Union than in Central and South-East Europe. Many of the economic problems faced by the new republics were rooted in the inefficient and unsustainable policies and institutions of the communist system, which actually brought about the collapse of the Soviet Union. But these problems were aggravated by the disintegration of what had been a unified economic space with integrated economic and social infrastructure unimpeded by borders.

| Share of merchandise trade with the former Soviet Union, 1988-2004(%) |
|--------------------------|-----------------|-----------------|-----------------|
|                         | 1988 | 1996 | 2004 |
| Total trade             |      |      |      |
| Kazakhstan              | 86   | 57   | 63   |
| Kyrgyzstan              | 87   | 78   | 69   |
| Tajikistan              | 86   | 45   | 51   |
| Turkmenistan            | 89   | n.a. | n.a. |
| Uzbekistan              | 86   | 21   | 32   |

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Exports</th>
<th>Imports</th>
<th>Total</th>
<th>Exports</th>
<th>Imports</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>57</td>
<td>70</td>
<td>63</td>
<td>21</td>
<td>49</td>
<td>32</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>69</td>
<td>58</td>
<td>51</td>
<td>40</td>
<td>62</td>
<td>52</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>31</td>
<td>32</td>
<td>27</td>
<td>32</td>
<td>41</td>
<td>36</td>
<td></td>
</tr>
</tbody>
</table>

*Source: IMF 1992 and 2004 and Asian Development Bank estimates*

As evident from the Table 1, during the Soviet era, the Central Asian republics had high levels of trade within the Union. However it was managed as part of the command economy, and not driven by the market forces. Like other Soviet

republics, those of Central Asia had little trade with the outside world. Table-1 suggests that before the disintegration of the Soviet Union, the Central Asian states’ trade with the rest of the countries of the former Soviet Union varied from as high as 86 to 89 per cent of their total trade with the rest of the world. With the dissolution of the Soviet Union and the easing of international travel restrictions, these Republics began to expand their trade ties with the rest of the world and consequently their trade with the former Soviet Republics declined to less than 50 per cent and in case of Kazakhstan and Uzbekistan 32 and 36 per cent respectively.

Despite some warnings of the consequences of economic disintegration, and despite some early efforts in the region to maintain orderly economic links among the new Central Asian republics, disintegration and economic collapse proceeded rapidly after the formal political dissolution of the Soviet Union in December 1991. The process went much beyond the immediate effects of systemic economic reform like macroeconomic stabilization, price liberalization, privatization, legal and regulatory reform and more generally the building of market institutions, etc. Some key elements were as follows:

- The integrated payment system and the non-cash inter-enterprise system collapsed, and the financial flow across the new borders dried up (especially once the unsustainable ruble zone collapsed and as hard-currency settlements were required across borders). More generally, inter-enterprise linkage broke down or at least suffered severely.
- Budgetary and investment subsidies were eliminated.
- Implicit price subsidies were reduced or eliminated, including for energy. According to some estimates, Russia’s price subsidies to other countries and republics amounted to $58 billion in 1990, of which $40 billion went to Central Asia.
- Formal customs and trade barriers were introduced. In addition, informal trade and transit barriers became common. Some borders were closed for reasons related to conflict, security or misguided economic policies.
- Transport prices were raised and transport services reoriented. A reduced frequency of trains and longer travel times were reported between Russia and other CIS republics. Air traffic collapsed from previously high levels.
Integrated power grids (in the South Caucasus and Central Asia) and integrated water systems (especially in Central Asia) gradually deteriorated, negatively affecting the quantity and quality of essential energy and water services for industry, irrigation and human consumption.

There was an exodus of minorities, among them about three million Russians, many of them highly skilled, who returned to Russia from other CIS republics, especially from Central Asia. They faced, and caused, significant resettlement problems in an economically depressed Russia.

The central Soviet administration collapsed, and new republican administrations had to be created. Tight control over internal security evaporated. War and civil unrest broke out in Tajikistan in the initial years after independence, leading to destruction, border closings, and millions of refugees and internally displaced persons.

Quantification of the economic impact of disintegration is difficult, but evidence suggests the view that it was a significant factor behind the transition recession, in general and in Central Asia in particular.

First, the transition recession was most severe for the small, landlocked republics most dependent on external links and financial transfers, especially the countries of Central Asia and the South Caucasus. In contrast, the transition recession was least serious for the countries in Central Europe, which were the least integrated into the Soviet system, although they too suffered a disintegration shock.

Second, the decline in trade was dramatic. Between 1990 and 1992, exports among the CIS republics dropped from $320 billion to $20 billion. While over time and to varying degrees the CIS countries were able to redirect their trade flows to the rest of the world, this did not offset the trade losses from the collapse of their intra-CIS commodity exchange.

Third, there is sporadic evidence that links the collapse of individual enterprises to disruption in the supply and demand chain as new borders went up and barriers to trade, transit and payments arose. A well-documented example is the case of the hay baler factory in Bishkek that supplied the entire Soviet Union. Similar examples exist for industrial and agricultural enterprises across the former Soviet Union.


44
Fourth, many people in Central Asia feel the impact of the new borders, especially those in the smaller countries. According to a World Bank Public Opinion Survey commissioned in late 2004, half of 6,000 respondents in Central Asia (except Turkmenistan) stated that the new borders have had a negative or very negative impact on trade, transit and transport, and therefore on access to friends, family and business. About 30 per cent said that borders have had a negative or very negative impact on access to water and electricity. For those who have actually crossed borders, the great majority noted problems due to loss of time, visas or other border procedures, and many reported dissatisfaction with the customs service and border guards, or said they had experienced harassment and humiliations of one kind or another. Uzbekistan was considered to have had the greatest increase in border problems. After independence, there was concern abut cross border national conflicts. Fortunately, as a great credit to the new national leaders, no serious conflicts of this type actually occurred. However, the potential for community-level cross-border conflict is reportedly high.

While the impact of political, economic and social disintegration was similar to that in many other parts of the former Soviet Union, in Central Asia it was more dramatic in many ways. This was due to the region's landlocked location, poverty, institutional weakness and political conditions, and due to the fact that Soviet integration was more artificial and deeply flawed for Central Asia than for other parts of the empire. There is no more visible example of the folly of central planning than the destruction of the Aral Sea through the development of a huge and inefficient, but ruthlessly programmed and implemented regional water allocation and irrigation system.

The political changes resulted in civil war and disturbance in Tajikistan. In the other Central Asian countries, the fear of loss of political control and perceived security threats have contributed to the establishment of tightly controlled borders and governments with varying degrees of authoritarianism.

With this backdrop this chapter covers the process of institutionalization of cooperation efforts in Central Asia in the sphere of economics. The chapter discusses officially recorded trade flows and then lists the types of commitments Central Asian leaders made towards trade liberalization and co-operation after 1991. It then outlines the various formal and informal barriers to trade that developed in
the region. This account also covers The Eurasian Economic Community (Evraziiskoe Ekonomicheskoe Soobshchestvo) and the WTO, including past and potential future implications for trading arrangements in the region. Then, it deals with a comparative analysis of the declared goals with the evidence of real progress made in the past.

The economic basis for regional cooperation in Central Asia has been shaped by the economic structure inherited from the Soviet Union. In former USSR, the supply of raw materials, particularly cotton, represented one of Central Asia’s primary economic functions. Simultaneously, however, all the Republics had infant industries for the manufacture of technologically sophisticated products. Therefore, it would be simplistic to view the Central Asian countries strictly as suppliers of raw materials, although these have been of central importance to the foreign trade strategies, of the individual countries.8

### Table 2
Central Asian Economies, Basic Characteristics, 2002

<table>
<thead>
<tr>
<th>Countries</th>
<th>Popul. (mln.)</th>
<th>GDP ($bln.)</th>
<th>GDP per capita ($USD)</th>
<th>Structure of GDP (%)</th>
<th>FDI stock ($)</th>
<th>Trade in GDP (%)</th>
<th>External Debt/ GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Industry</td>
<td>Agriculture</td>
<td>Services</td>
<td></td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>14,5</td>
<td>24,4</td>
<td>1668</td>
<td>25,2</td>
<td>10,1</td>
<td>64,7</td>
<td>15,354</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>4,8</td>
<td>1,6</td>
<td>334</td>
<td>19,1</td>
<td>35,6</td>
<td>45,3</td>
<td>415</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>6,4</td>
<td>1,1</td>
<td>187</td>
<td>19,3</td>
<td>21,1</td>
<td>57</td>
<td>162</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>5,8</td>
<td>NA</td>
<td>648</td>
<td>50</td>
<td>21</td>
<td>29</td>
<td>1,163</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>25,6</td>
<td>9,7</td>
<td>308</td>
<td>14,1</td>
<td>30,6</td>
<td>55,3</td>
<td>1,332</td>
</tr>
</tbody>
</table>


As Table 2 suggests, Central Asian states can be categorized into two distinct groups. On the one hand, Uzbekistan and Turkmenistan, where the economic output since 1991 has decreased by about 17 or 26 per cent respectively; on the other hand, Kazakhstan, Kyrgyzstan and Tajikistan, with decrease in economic output ranging between 43 and 50 per cent since 1991.9 Kazakhstan, Kyrgyzstan and Tajikistan also recorded dramatic slump in industrial production, whereas Uzbekistan was able to maintain its industrial production near 1991 levels.

---

8 Wacker, 1994, p.3.
Intraregional trade is the most important determinant of economic cooperation among the countries of a given region. On this count Central Asian picture looks gloomy as these countries produce roughly the same set of goods. Therefore market for them lies outside. As Boris Rumer has argued, these economies do not supplement each other. Table-3 gives a clear picture of the composition of the intraregional trade in Central Asia. There is a great deal of overlapping in the goods produced by the Central Asian countries. The significance of intraregional trade in Central Asia will be dealt with in detail in the succeeding part of this chapter.

2.2 Intraregional Trade of Goods

Table 3
Composition of Intraregional trade in Central Asia.

<table>
<thead>
<tr>
<th>Exports To</th>
<th>Kazakhstan</th>
<th>Kyrgyzstan</th>
<th>Tajikistan</th>
<th>Uzbekistan</th>
<th>Xinjiang, PR China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>Electricity, Antimony, Sulphur, Tobacco, Ores &amp; Scrap, Textiles</td>
<td>Asbestos &amp; Cement, Flour, Natural Gas</td>
<td>Electricity, Meat and Milk, Coal Ores &amp; Scrap, Wool, Cloth, Sugar, Medicines</td>
<td>Hides, Wool, Cotton, Metal</td>
<td></td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>Aluminium, Ore, Ethanol, Fruits</td>
<td>Electricity, Ethanol, Ore</td>
<td>Electricity, Aluminium, Rail Services</td>
<td>Cotton</td>
<td></td>
</tr>
<tr>
<td>Tajikistan</td>
<td>Natural Gas, Electricity, Cotton, Consumer goods</td>
<td>Natural Gas, Fertilizer, Fuel, Oil, Gasoline</td>
<td>Petroleum products, Fertilizers, Cement, Fabric</td>
<td>Cotton, Fertilize, Wool</td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The composition of intraregional trade reflects the handicaps faced by Central Asian states. A meaningful economic cooperation among them is possible only when there is some heterogeneity in the goods produced by them. However, as the Table-3 suggests, this is not the case in Central Asia. This region remains homogeneous in terms of the goods produced by them which mainly consist of either raw materials, natural resources, oil, natural gas and electricity. In this context

---

the disintegration of the former Soviet Union further made the matters worse as the share of intraregional trade among these states have significantly gone down since then as illustrated in the following section.

2.3 Officially Recorded Trade Flows in Central Asia

Kazakhstan has shifted much of its export away from the CIS market, with 78.8 per cent in 2004 going to countries outside the CIS.\(^{11}\) Exports to Uzbekistan, Kyrgyzstan and Tajikistan accounted for only USD 370 million of Kazakhstan’s overall export of USD 12,927 million in 2003.\(^{12}\)

**Table 4**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kyrgyzstan</td>
<td>60</td>
<td>75</td>
<td>112</td>
<td>66</td>
<td>62</td>
<td>60</td>
<td>58</td>
<td>87</td>
<td>109</td>
<td>156</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>10</td>
<td>40</td>
<td>61</td>
<td>55</td>
<td>42</td>
<td>46</td>
<td>53</td>
<td>61</td>
<td>46</td>
<td>76</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>277</td>
<td>153</td>
<td>202</td>
<td>148</td>
<td>66</td>
<td>66</td>
<td>66</td>
<td>134</td>
<td>150</td>
<td>101</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>347</td>
<td>268</td>
<td>375</td>
<td>269</td>
<td>224</td>
<td>172</td>
<td>245</td>
<td>298</td>
<td>256</td>
<td>370</td>
</tr>
<tr>
<td>Russia</td>
<td>1438</td>
<td>2366</td>
<td>2484</td>
<td>2288</td>
<td>1611</td>
<td>1139</td>
<td>1751</td>
<td>1760</td>
<td>1498</td>
<td>1968</td>
</tr>
<tr>
<td>Total export</td>
<td>3277</td>
<td>3231</td>
<td>4974</td>
<td>6497</td>
<td>5334</td>
<td>5872</td>
<td>8812</td>
<td>8639</td>
<td>9670</td>
<td>12927</td>
</tr>
</tbody>
</table>


**Table 5**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kyrgyzstan</td>
<td>104</td>
<td>31</td>
<td>91</td>
<td>64</td>
<td>53</td>
<td>31</td>
<td>30</td>
<td>33</td>
<td>32</td>
<td>55</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>18</td>
<td>12</td>
<td>18</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>-</td>
<td>270</td>
<td>89</td>
<td>66</td>
<td>96</td>
<td>87</td>
<td>71</td>
<td>81</td>
<td>87</td>
<td>90</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>-</td>
<td>313</td>
<td>198</td>
<td>136</td>
<td>153</td>
<td>120</td>
<td>106</td>
<td>116</td>
<td>122</td>
<td>152</td>
</tr>
<tr>
<td>Russia</td>
<td>1293</td>
<td>1900</td>
<td>2325</td>
<td>1969</td>
<td>1712</td>
<td>1351</td>
<td>2439</td>
<td>2892</td>
<td>2549</td>
<td>3282</td>
</tr>
<tr>
<td>Total export</td>
<td>3887</td>
<td>3561</td>
<td>3781</td>
<td>4301</td>
<td>4314</td>
<td>3655</td>
<td>5040</td>
<td>6446</td>
<td>6584</td>
<td>8327</td>
</tr>
</tbody>
</table>


Russia has retained its position as a key trading partner of Kazakhstan, although the data above indicate a slight decrease in volume. The economic crisis of 1997-98 triggered a slump in trade, though by 2003 the volume of exports to Russia had been restored to levels close to those of 1994. Imports and exports to Uzbekistan

---


have decreased significantly, from USD 277 million in 1994 to USD 138 million by 2003. Exports to Kyrgyzstan and Tajikistan increased, but these trade flows remain marginal in terms of importance to Kazakhstan’s economy – USD 156 million in exports to Kyrgyzstan and USD 76 million in exports to Tajikistan in 2003, out of a total Kazakhstani export of over USD 12 billion.

Uzbekistan, by contrast, has continued to rely more on the CIS as an export market. In 2004, 36.9 per cent of its export went to CIS countries. As with Kazakhstan, however, very little of the CIS exports have been directed to its immediate Central Asian neighbours. Only USD 120 million worth of Uzbekistan’s exports went to Tajikistan in 2003, and as little as USD 35 million worth of goods went to Kyrgyzstan. Similarly, only USD 81 million in goods were exported to Kazakhstan. Both export figures are remarkably low, given the overall size of the economies of these two countries.

Table 6

Uzbekistan’s Exports, (million US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>-</td>
<td>245</td>
<td>81</td>
<td>60</td>
<td>87</td>
<td>.78</td>
<td>64</td>
<td>73</td>
<td>78</td>
<td>81</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>64</td>
<td>120</td>
<td>116</td>
<td>111</td>
<td>46</td>
<td>68</td>
<td>60</td>
<td>54</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Tajikistan</td>
<td>76</td>
<td>229</td>
<td>181</td>
<td>237</td>
<td>206</td>
<td>240</td>
<td>168</td>
<td>137</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>-</td>
<td>538</td>
<td>382</td>
<td>413</td>
<td>404</td>
<td>364</td>
<td>300</td>
<td>270</td>
<td>252</td>
<td>236</td>
</tr>
<tr>
<td>Russia</td>
<td>774</td>
<td>808</td>
<td>593</td>
<td>923</td>
<td>473</td>
<td>423</td>
<td>602</td>
<td>527</td>
<td>310</td>
<td>436</td>
</tr>
<tr>
<td>Total export</td>
<td>1929</td>
<td>2708</td>
<td>2675</td>
<td>2896</td>
<td>2310</td>
<td>1962</td>
<td>2132</td>
<td>2079</td>
<td>1539</td>
<td>1953</td>
</tr>
</tbody>
</table>


Table 7

Uzbekistan’s Imports, (million US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>304</td>
<td>168</td>
<td>222</td>
<td>163</td>
<td>131</td>
<td>73</td>
<td>146</td>
<td>165</td>
<td>111</td>
<td>151</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>-</td>
<td>98</td>
<td>127</td>
<td>111</td>
<td>42</td>
<td>51</td>
<td>98</td>
<td>52</td>
<td>30</td>
<td>17</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>25</td>
<td>145</td>
<td>210</td>
<td>189</td>
<td>138</td>
<td>199</td>
<td>107</td>
<td>95</td>
<td>80</td>
<td>73</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>-</td>
<td>411</td>
<td>559</td>
<td>463</td>
<td>311</td>
<td>323</td>
<td>351</td>
<td>312</td>
<td>221</td>
<td>241</td>
</tr>
<tr>
<td>Russia</td>
<td>917</td>
<td>907</td>
<td>1191</td>
<td>962</td>
<td>533</td>
<td>264</td>
<td>301</td>
<td>400</td>
<td>498</td>
<td>553</td>
</tr>
<tr>
<td>Total export</td>
<td>2321</td>
<td>3030</td>
<td>4901</td>
<td>4537</td>
<td>2930</td>
<td>2481</td>
<td>2071</td>
<td>2292</td>
<td>2079</td>
<td>2481</td>
</tr>
</tbody>
</table>


The data shows a near halving of exports to Russia between 1994 and 2003, with sharp declines in 1996, 1998 and 2002. On the whole, Uzbekistan’s exports to Kyrgyzstan decreased, though there was a period of relatively high export volumes in the years from 1996-1998. Tajikistan also received relatively high volumes of exports between 1995 and 1999, followed by a steady decrease in the period 1999-2003.

Kyrgyzstan directed 36.5 per cent of its total exports to the CIS in 2003. Until 2002, the share of Kyrgyzstan’s exports going to Tajikistan, Uzbekistan and Kazakhstan was higher than that going to Russia. In 2003, Kyrgyzstan exported goods at a value of 97 million USD, while the three other countries received goods from Kazakhstan totaling 91 million USD that year. Kazakhstan received the bulk of this regional export. In 2003, it imported goods worth 57 million USD.

Table 8

Kyrgyzstan’s Exports, (million US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>95</td>
<td>113</td>
<td>112</td>
<td>87</td>
<td>85</td>
<td>44</td>
<td>33</td>
<td>39</td>
<td>36</td>
<td>57</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>3</td>
<td>5</td>
<td>12</td>
<td>12</td>
<td>8</td>
<td>9</td>
<td>7</td>
<td>6</td>
<td>10</td>
<td>18</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>44</td>
<td>89</td>
<td>115</td>
<td>101</td>
<td>38</td>
<td>46</td>
<td>89</td>
<td>47</td>
<td>27</td>
<td>16</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>142</td>
<td>207</td>
<td>239</td>
<td>200</td>
<td>131</td>
<td>99</td>
<td>129</td>
<td>92</td>
<td>73</td>
<td>91</td>
</tr>
<tr>
<td>Russia</td>
<td>-</td>
<td>114</td>
<td>134</td>
<td>98</td>
<td>83</td>
<td>70</td>
<td>65</td>
<td>64</td>
<td>80</td>
<td>97</td>
</tr>
<tr>
<td>Total export</td>
<td>-</td>
<td>409</td>
<td>505</td>
<td>603</td>
<td>513</td>
<td>453</td>
<td>504</td>
<td>476</td>
<td>485</td>
<td>581</td>
</tr>
</tbody>
</table>


Table 9

Kyrgyzstan’s Imports, (million US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>58</td>
<td>67</td>
<td>140</td>
<td>69</td>
<td>75</td>
<td>72</td>
<td>57</td>
<td>81</td>
<td>123</td>
<td>170</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>-</td>
<td>8</td>
<td>6</td>
<td>10</td>
<td>6</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>64</td>
<td>70</td>
<td>132</td>
<td>128</td>
<td>122</td>
<td>50</td>
<td>75</td>
<td>66</td>
<td>60</td>
<td>39</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>-</td>
<td>145</td>
<td>278</td>
<td>207</td>
<td>203</td>
<td>126</td>
<td>133</td>
<td>148</td>
<td>186</td>
<td>212</td>
</tr>
<tr>
<td>Russia</td>
<td>-</td>
<td>105</td>
<td>175</td>
<td>190</td>
<td>204</td>
<td>109</td>
<td>132</td>
<td>85</td>
<td>116</td>
<td>176</td>
</tr>
<tr>
<td>Total export</td>
<td>-</td>
<td>522</td>
<td>838</td>
<td>709</td>
<td>841</td>
<td>599</td>
<td>554</td>
<td>467</td>
<td>586</td>
<td>717</td>
</tr>
</tbody>
</table>


Exports from Kyrgyzstan to both Russia and the three Central Asian countries have dropped markedly since 1996. Export flows to Uzbekistan in particular have fallen, despite a slight recovery in 2000. These downturns contrast with the increase in Kyrgyzstan's total exports since 1995. The country's interdependence with Kazakhstan has increased markedly since 2000. Today it is Kazakhstan, and not Uzbekistan, that is Kyrgyzstan's main regional trading partner. In 2003 Kyrgyzstan imported nearly as much from Kazakhstan (US$ 170 million) as from Russia (US$ 179 million).

Tajikistan was estimated to export 13.9 per cent of its goods to the CIS in 2004.\textsuperscript{15} The country differs from Kazakhstan and Kyrgyzstan in having a relatively high share of exports going to Uzbekistan. Of total exports (US$ 790 million) in 2003, US$ 74 million went to the three countries – and here Uzbekistan's share was US$ 67 million. Nevertheless, Russia has remained important. Both Tajikistani exports (US$ 52 million) and imports (US$ 178 million) to and from Russia were nearly as high, or for import higher, than those to or from Uzbekistan in 2003.

### Table 10

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>10</td>
<td>7</td>
<td>24</td>
<td>10</td>
<td>10</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>2</td>
<td>3</td>
<td>10</td>
<td>9</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>23</td>
<td>132</td>
<td>191</td>
<td>172</td>
<td>125</td>
<td>180</td>
<td>97</td>
<td>87</td>
<td>72</td>
<td>67</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>35</td>
<td>142</td>
<td>225</td>
<td>191</td>
<td>140</td>
<td>186</td>
<td>104</td>
<td>92</td>
<td>78</td>
<td>74</td>
</tr>
<tr>
<td>Russia</td>
<td>46</td>
<td>95</td>
<td>79</td>
<td>63</td>
<td>47</td>
<td>115</td>
<td>258</td>
<td>104</td>
<td>87</td>
<td>52</td>
</tr>
<tr>
<td>Total export</td>
<td>492</td>
<td>749</td>
<td>770</td>
<td>803</td>
<td>596</td>
<td>688</td>
<td>770</td>
<td>651</td>
<td>737</td>
<td>790</td>
</tr>
</tbody>
</table>


\textsuperscript{15} IMF Republic of Tajikistan: selected issues and statistical appendix (Washington, DC: International Monetary Fund, 2005).
Table 11

Tajikistan’s Imports, (million US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>33</td>
<td>27</td>
<td>52</td>
<td>42</td>
<td>51</td>
<td>78</td>
<td>82</td>
<td>89</td>
<td>72</td>
<td>95</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>1</td>
<td>3</td>
<td>7</td>
<td>5</td>
<td>5</td>
<td>7</td>
<td>7</td>
<td>5</td>
<td>5</td>
<td>27</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>83</td>
<td>251</td>
<td>199</td>
<td>261</td>
<td>227</td>
<td>264</td>
<td>185</td>
<td>150</td>
<td>132</td>
<td>132</td>
</tr>
<tr>
<td>Total for the 3 countries</td>
<td>117</td>
<td>281</td>
<td>258</td>
<td>308</td>
<td>283</td>
<td>349</td>
<td>274</td>
<td>244</td>
<td>209</td>
<td>254</td>
</tr>
<tr>
<td>Russia</td>
<td>61</td>
<td>136</td>
<td>74</td>
<td>115</td>
<td>102</td>
<td>92</td>
<td>105</td>
<td>129</td>
<td>163</td>
<td>178</td>
</tr>
<tr>
<td>Total export</td>
<td>547</td>
<td>810</td>
<td>668</td>
<td>750</td>
<td>711</td>
<td>663</td>
<td>670</td>
<td>680</td>
<td>710</td>
<td>880</td>
</tr>
</tbody>
</table>


The data indicate a steady decrease in the size and significance of Uzbekistan’s exports and imports to Tajikistan in the period 1994 to 2003. There was a gradual but slight increase in Tajikistan’s Russian imports, while its exports to Russia peaked in 2000 but have since declined. Kazakhstan and Kyrgyzstan have remained marginal destinations for exports from Tajikistan, although both (Kazakhstan in particular) have increased their significance as exporters to Tajikistan. However, trade volumes are still very low.

The above mentioned figures show that the trend in intraregional trade flows was predominantly negative. Most states saw a drop in the volume of trade with neighbouring states in this period. Exchanges involving Uzbekistan had a particularly bleak trend, but some minor improvements were visible in Kazakhstan–Kyrgyzstan exchanges and in Kazakhstan’s exports to Tajikistan. Overall, the states in Central Asia traded less and less with each other in the period from 1991-2004, although some of decline in reported trade flows was also due to the fact that traders in Central Asia were increasingly operating outside the formal economy.

These data also indicate that Russia remained a key trading partner, although export markets outside the region and beyond Russia grew in importance for the four countries. This growth can be attributed to the predominance of Central Asian states’ raw material exports. Key export flows to markets beyond the former Soviet Union consisted of oil, gas, cotton, aluminium and minerals. The Central Asian states shared an over-reliance on the export of raw materials. This reliance made for low trade complementarities, as they appeared as competitors on world markets in
similar products categories. In this way, the pattern of trade exchanges was a further indication of the low levels of interdependence among the states of Central Asia.

Of the four states, Uzbekistan had relatively high trade interdependence with its neighbours and also with the CIS. However, it could not generate a push towards regional cooperation. In contrast, Uzbekistan has lagged behind in trade facilitation and liberalisation, with regard to both the CIS and Central Asia. Kazakhstan, by contrast, has been a diplomatically keen supporter of CIS and regional free trade arrangements – even though CIS and Central Asian export and imports are much less significant for its economy than for Uzbekistan’s. Policy choices, and not trade flows, seems to underpin diplomatic cooperation initiatives.

2.4 Understanding Patterns of Regional Trade in Central Asia

Trade levels declined sharply in Central Asia in the early 1990s, reflecting the breakdown of trade links and payment mechanisms among the countries of the former Soviet Union. Trade started recovering in the mid-1990s, as the Central Asian countries partly reoriented their trade from Soviet to post-Soviet system, and established new trade links and payment mechanism with the former Soviet Republics, largely based on market principles. This recovery was interrupted by the Russian financial crisis of 1998, by declines in world commodity prices in the late 1990s, by devaluation of the national currency in some Central Asian countries, and in the case of Turkmenistan, by suspension of exports of Natural Gas to Ukraine in 1997. Trade levels rose considerably from 2000 to 2004, largely due to increased demand and higher prices for primary commodities in world markets, and a recovery of investment and hence a strong demand for capital goods in Central Asia.

The commodity composition of trade in the Central Asian countries has not changed significantly since the break up of the Soviet Union. Exports have remained concentrated in a handful of primary commodities, such as crude oil, gas, metals and cotton fibre. Crude oil accounted for 57 per cent of exports from Kyrgyzstan. Aluminum and cotton made up 82 per cent of exports from Tajikistan in 2003. Even in Turkmenistan and Uzbekistan, which have adopted the strategy of import-substituting industrialization and have been trying to promote exports of high value-added manufactured products through extensive state intervention, primary commodities continue to dominate exports. Natural gas, cotton and crude oil
accounted for 56 per cent of exports from Turkmenistan in 2003, and gold comprised 49 per cent of export from Uzbekistan in 2004. At the same time, finished products, including machinery, equipment and consumer goods, have remained dominant items of imports.

During the Soviet era, the Central Asian Republics had high levels of trade within the Soviet Union, but it was managed as part of the command economy, not driven by market forces. Like other Soviet Republics, those of Central Asia had little trade with the outside world. One of the benefits of independence was the opportunity to seek out the best markets for export in the global economy. However, this process was constrained by a variety of factors, including the need to establish new transport and trade links, limited competitiveness of Central Asian manufactured exports in international markets and the lack of hard currency. As some of these constraints were eased or removed, the share of the former Soviet countries in Central Asian countries' trade significantly decreased. The decline was especially swift and dramatic in Uzbekistan, reflecting the fact that it was relatively easy there to reorient exports of internationally marketable commodities, such as gold and cotton, from the former Soviet countries to international markets. The reorientation of trade in Central Asia away from the former Soviet countries and towards the rest of the world was, however, partly reversed in recent years. Uzbekistan’s exports to other former Soviet countries expanded considerably partly due to increased exports of transportation equipment. Imports from former Soviet Republics to Central Asian countries increased substantially following devaluation of the national currency in many former Soviet countries in the 1990s.

Today, Central Asian countries trade relatively little among themselves. There may be a statistical bias, since local trade is more likely to go unrecorded than long-distance trade. But even despite this, trade within the region is probably low. This can be explained not only by national trade and foreign exchange policies, and by the lack of cooperation in trade, transport, customs and border management described later in this chapter, but also by the similarity of economic structures of Central Asian countries. These countries will ultimately find greater opportunities for trade with dissimilar and hence complementary economies farther away, provided they overcome the barriers that stand in the way of access to world

markets. Both trade within the region and with the rest of the world, however, will depend on regional cooperation to reduce trade costs.

With the dissolution of the Soviet Union and the easing of international travel restrictions, individual traders started making shopping trips to neighbouring countries and to places as far away as China, Turkey and the Gulf States, bringing consumer goods home to sell in the markets of Central Asia. This small-scale, cash-based trade became known as the shuttle trade. It has persisted mainly because regulations and other trade costs discourage the establishment of larger, more formal trading companies that would improve trade efficiency. However, it has also provided important employment and commercial opportunities for lower-income people and helped develop new trade flows across borders. Depending on the frequently changing laws and regulations of each country, shuttle trade can be legal or illegal, making it often an uncertain and hazardous undertaking for the people involved.

As price differentials emerged in Central Asian markets due to different regulatory regimes, new opportunities opened for cross-border arbitrage, and in particular for the shuttle trade. This primarily involves the borders of Turkmenistan and Uzbekistan, the countries with the most regulated prices. There is substantial transport of goods, especially petrol, from Turkmenistan, where the price is very low, to Uzbekistan. In the Fergana Valley, by contrast, petrol is brought across the border from Uzbekistan, where the price is regulated, into the freer market economies of Kyrgyzstan and Kazakhstan, in return for consumer goods that are unavailable in Uzbekistan. In the early 2000s, the Dordoi market in Bishkek, the Kara-Suu Market near Osh and markets at Chymkent in Kazakhstan became major destinations for shuttle traders from Uzbekistan as access to consumer goods in Uzbekistan was increasingly restricted.

The shuttle trade is largely carried out by women for two principal reasons. First, men still rely more on regular earnings and are tied to their workplaces, which they cannot leave for travel to other countries in order to buy goods and sell them at home. Women are tied to their homes while their children are young, but when the children have grown up, or older children can take care of younger ones, women earn a living outside the home – very often as shuttle traders. Second, border guards and customs officials are generally more lenient towards women than men. Yet systematic or arbitrary restrictions are often placed on the shuttle trade by the
government (as was the case in Uzbekistan in 2002 and 2004, for example)\textsuperscript{17} or by corrupt border, customs and tax officials. This makes shuttle trade a difficult business. People turn to it mainly as a coping mechanism when there are few alternative job opportunities.

Despite frequent interference in the shuttle trade by official policy or corrupt officials, its size is believed to be large. It is poorly documented and difficult to estimate, as traders try to avoid the authorities’ attention and routinely under-invoice their imports (if necessary, by paying customs officials not to notice their baggage). According to estimates made by Kyrgyz experts for the Asian Development Bank, unrecorded imports of consumer goods, gasoline and diesel fuel were equivalent to 17 per cent of Kyrgyzstan’s recorded imports in 2003, while unrecorded exports of the small-scale sewing industry and re-exports of imported consumer goods amounted to 20 per cent of its recorded exports. In short, shuttle trade is an essential part of trade in Central Asia and has important implications for the reduction of poverty.

2.5 Regional Initiatives in Trade Cooperation since 1991

Considerable diplomatic efforts have been undertaken to establish a framework for a free trade area in Central Asia. On 10 January 1994 Kazakhstan and Uzbekistan signed the ‘Agreement on the formation of a single market’ in Tashkent,\textsuperscript{18} while Kyrgyzstan followed suit six days later in Bishkek. This agreement was the basis for the establishment of the Central Asian Economic Community (Tsentral’no Aziatskoe Ekonomicheskoie Soobshchestvo, TsAES), renamed the Central Asian Cooperation Organisation (Tsentral’no-Aziatskoe Sotrudnichestvo, TAS), on 28 February 2002.\textsuperscript{19} Tajikistan joined the organization in 1998. Its main purpose was defined as implementation of joint programs on deepening economic integration, and the establishment of conditions for free movement of goods, services, labour and capital; concerted steps in pursuing credit

\textsuperscript{17} Interviews commissioned by the Asian Development Bank.

\textsuperscript{18} Kazakhstan, Kyrgyzstan and Uzbekistan Dogovor o sozdaniii edinogo ekonomicheskogo prostrantva mezhdu Kirgizskoi Respublikoi, Respublioki Kazakhstani i Respublikoi Uzbekistan (Tashkent 10 January 1994).

\textsuperscript{19} G.G. Rakhmatulina, Dinamika razvitia integratsionnykh protsessov v gosudarstvakh SNG i perspektivy formirovaniia edinogo ekonomicheskogo prostranstva (Almaty: Kazakhstanskii Institut Strategicheskikh Issledovanii pri Prezidente Respubliki Kazakhstan, 2004), p.94.
and accounting, fiscal, tax, price, customs and foreign exchange policies. The document which was the first sincere effort in the direction of creating a common economic space became a legal basis for cooperation between the four states.

The 1994 agreement led to intense efforts to establish institutions and legal frameworks for cooperation and the facilitation of a common market. In Article 4 of the 1994 agreement, the countries pledged to introduce joint customs procedures, regulate import duties (poshлина), lower taxes, simplify customs procedures, harmonise customs legislation, and introduce uniform documentation requirements. In 1995 they adopted an extensive five-year plan for the realization of the common market. This plan was followed by another in 1998, when the member states adopted a programme of action for the formation of a common market and for the integration of the TsAES countries. These initiatives were primarily as a result of common regional interests to look for the ways for a more rational use of regional resources in the worsening economic situation, partly caused by the collapse of trade relations with the other parts of the former Soviet Union.

As the President of Kyrgyzstan pointed out in the early 1990s:

"We should meet each other from time to time in order to discuss our work, the measures taken in our republics. Our main task is to set up a common infrastructure for the republics of Central Asia to move towards a market economy."

During a working visit to Tashkent by Kyrgyzstan’s Prime Minister in July 1999, joint measures to realise a Central Asian economic free zone of the year 2000 ranked high on the agenda. Despite these developments, the period 1998-1999 witnessed relatively slow progress in intraregional relations. There are probably two main explanations for that: economic and political. The former was related to the fact that all the countries managed to reach some degree of domestic macroeconomic stabilization with the first signs of economic growth. It enforced some states to put through with further reforms. Yet the situation remained relatively fragile, as August 1998 financial crisis in Russia had a strong effect on Kazakhstan

---

22 Rakhmatulina, Dinamika razvitia integratsionnykh protsessov.
and Kyrgyzstan, and to a lesser degree on Uzbekistan. The first two states kept up very close relations with the Russian economy, which finally ensured a spillover effect of the Russian crisis. Kyrgyzstan was already saddled with its rising external debts problems, when the crisis raised substantially the doubts on the returns from the reforms, leading the country to halt or even reverse its economic plans. Kazakhstan was even strongly shaken by the crisis which fuelled domestic inflationary trends. Being more concerned in macroeconomic stabilization, it was hard for Kazakhstan to ensure the committed terms on sustainable and consequent customs and transit policies with respect to its neighbours, which finally resulted in transit fees going up. Although Uzbekistan was insulated from direct impact of the Russian crisis, higher prices in Kazakhstan and Russia had its negative influence on its import and export opportunities. As was known from history, if the Central Asian countries had had to face with direct economic problems, they would have preferred to act more unilaterally by favouring national interests, rather than following any common regional approach to address these problems through appropriate coordination. In addition to these economic factors, the political side of the issue is seen by some experts in that Kazakhstan and Kyrgyzstan, for fear of Uzbekistan's military preponderance and strong-arm strategies in security-related issues, held back from direct cooperation within the Central Asian Economic Community and tried to search for closer cooperation with other states in the frame of other regional groupings, such the Shanghai Cooperation Organization, or the Eurasian Economic Community, for instance, though it is rather difficult to assess the real impact of the given factor on their decisions.

In subsequent period the region had to confront mainly with geopolitical issues both within and around the region. In 2000, at the Dushanbe summit of heads of state, the leaders adopted a strategy for integrated development for the period 2000-2005. Uzbekistan's Islam Karimov used the TAS meetings in 2001 and 2002 to re-work and re-launch a strategy for achieving a common market – this time to be realised in three stages over a fifteen-year period. Since then, Uzbekistan has retained the lead in developing a concept for this proclaimed three-stage realisation.

As with most TAS agreements, the common market initiative was accompanied by ambitious rhetoric from Central Asian state leaders. At a TAS summit on 28 May 2004, Uzbekistan's President Islam Karimov noted:
the significance of (TAS) as one of the important institutions of Central Asian cooperation is growing immensely....our capabilities and interests for our region will increase immensely if we unanimously declare and make a critical decision regarding our aim gradually to create the Central Asian single market. In our opinion it should be a common, large and capacious market of commodities, services, workforce and funds. Only a market that is not divided into narrow national borders is able to sustainably attract a significant inflow of investment into all branches of the economy.24

Initiatives for creating a free trade area were complemented by efforts to establish regional institutions. As noted in chapter 1 the states agreed in 1994 to form an Inter-State Council consisting of heads of states of the three countries to serve as the main forum for decision-making. They also established a permanent implementing committee.25 The member states agreed in 1994 to establish the Central Asian Development Bank. Its capital was formed by equal injections from each of the three member states, and its main activities were to ensure inter-state settlements, assist the development of regional trade, finance various projects of both regional and national significance in each state. In general, the bank financed some moderate projects (from $500,000 to $5 million) in each country. It also helped economic entities from the member states prepare business plans preparatory to loans. Besides, it received grants from some foreign governments and multinational banks for its work and correspondent relations with several important overseas and regional banks. However, from the beginning, the activities of the bank were very limited, and they remained so in subsequent years.

Since 2002, the regional processes have been influenced by the incremental and broad contacts with the non-regional partners. Since then, the region was visited by so many top level delegations, especially from the USA, EU and other bi- and multilateral organizations, which had been never ever seen during the entire period of Central Asia’s independent development. All the countries tended to pursue multi-vector foreign policies by expressing their willingness to cooperate with the USA and West in general in the military field. Equally all of them had already been the members of the Shanghai Cooperation Organisation, while Kazakhstan, Tajikistan and Kyrgyzstan were also the members of the Russia led Collective Security Treaty Organization.

25 Rakhmatulina, Dinamika razvitia integratsionnykh protsessov, p.94.
The Economic Cooperation Organization (ECO), which the newly independent Central Asian countries all joined in 1992, also aims to be a regional trading arrangement. The three founding members (Iran, Pakistan and Turkey) offer preferential tariff treatment to one another, but the list of eligible products is extremely restricted. The five Central Asian countries, together with Afghanistan and Azerbaijan, have expressed commitment of ECO principles, but have made no move towards preferential tariffs. Trade between the five Central Asian countries and their southern neighbours has expanded since 1992, but from a low base and more slowly than many observers expected. Moreover, it has done so on a non-discriminatory (most-favoured nation) basis rather than within a regional trading arrangement such as the ECO founding members appear to have envisaged.

These regional arrangements have often been in implicit competition with each other, reflecting differing and mutually exclusive political pacts. Overall, an ebb and flow of interest in alternative permutations have inhibited the institutional development of any particular regional organization. Progress towards a customs union has been slow or virtually non-existent over the past decade, as there has not been any enforcement or arbitration mechanism for implementation. In fact, agreements to make internal free-trade mandatory or to harmonize external trade policies have been practically fruitless, and none has posed a threat to multilateralism in the Central Asian countries trade policies. Their economic impact had been minimal.

Two principal reasons for this outcome stand out. First, the governments of the new Central Asian countries have been unwilling to constrain their newly acquired sovereignty by getting bound into what they fear might be regional straightjackets recreating some of the political constraints of past history. Second, good economic reasons hinder preferential regional trading arrangements. One basic argument relates to the likelihood of trade diversion. Preferential duties on imports from a neighbour will encourage consumers to purchase some goods that appear to be better value than the tariff-inclusive price of lower-cost or higher-quality imports. The governments of the importing country lose tariff revenue and consumers are worse off than they would be with non-discriminatory tariff reductions. Although the political leaders may not express their concerns in terms such as ‘trade

---

diversion', when it comes to implementation of agreements, they recognize that while they may want to expand the market for their country's own sheltered industries, they do not want to give preferential status to their neighbours' manufactured goods. Buying imports from the global least-cost supplier and selling exports in the best market makes considerable economic sense, and was clearly a key reason for the failure of the many discriminatory trading arrangements in Africa and Latin America during the second half of the 20th century.\(^\text{27}\)

In short, regional preferential trade agreements have not worked in Central Asia for political and economic reasons and are not likely to do so in the near future.\(^\text{28}\) Under these circumstances focusing attention on the WTO and supporting regional cooperation that focuses on reducing the trade barriers arising from poor transport infrastructure and weak trade facilitation may be a better option for them.

### 2.6 Cooperation within WTO Framework

In many respects, multilateralism formalized by WTO membership remains the best framework for developing international economic relations. At the current moment, however, despite their dismal history, proposals for regional trading arrangements in Central Asia continue unabated, whether in the form of calls for a free-trade area, a customs union or deeper economic union.

At the Central Asia Cooperation Organisation (CACO) summit on 28 May 2004 in Astana, President Karimov of Uzbekistan proposed the establishment for a Central Asian Common Market (CACM), based on the CACO institutional framework and including Afghanistan. The key objective of the CACM would be to improve the living standards of the Central Asian people through the optimal use of regional resources, including water and energy, and natural, physical and human capital; and by developing common strategies for creating a favourable investment climate for domestic and foreign investors. This was envisaged as long-term initiative to be implemented in three phases.

1. Establishment of an effective free-trade area;
2. Creation of a customs union within five years after the establishment of a free-trade area;

\(^{27}\) Abache, Jorge Saba, Andy Dickerson and Francis Green, "Trade Liberalization and wages in Developing Countries", *The Economic Journal*, 2004, 114(493): F73 - F96.

3. Establishment of a common market within five to seven years after the creation of a customs union

Since the proposal was made in May 2004, however, there has been little notable progress in further deepening and implementing it. Moreover its future is uncertain now that the CACO has been merged with the Eurasian Economic Community (EEC).

At the eighth ECO summit in Dushanbe in September 2004, Iran proposed committing to an ECO free-trade zone by 2015. In March 2005, President Karimov and Kazakhstan’s President Nazarbayev set up a working group on creating a free-trade zone between the two countries.29

There is room and need for regional cooperation in trade within a multilateral framework. First, the Central Asian countries may want to coordinate their trade policies and carry out non-discriminatory trade liberalization in a concerted manner, as has been done in the Asia-Pacific region by many Asia Pacific Economic Cooperation member countries. Second, they can also join efforts with each other and other countries to gain better access to markets in developed countries, and to push for the discontinuation of trade-distorting agricultural subsidies. Third and most importantly, regional cooperation should urgently focus on the issues of regional transport and trade facilitation. The barriers imposed by the current arrangements are much more serious impediment to trade than trade policy per se.

In conclusion, it can be noted that, as Boris Runner has argued, the Central Asian states lack objective preconditions for regional unity in so far as they have neither a shared interest in a single market, as in the European Union, nor large investment resources from one of the member states, as in the North American Free Trade Agreement.30

The structural context in which sub-regional initiatives are taking place in Central Asia is more akin to that of Africa, than of Europe, North America or South-East Asia. As in Africa, intraregional trade intensity in Central Asia is relatively low and external trade dependence is high, exports consist mainly of agricultural and

29 Summary of World Broadcast, BBC (Online), March 26, 2005.
mineral products, informal trade is of great significance and there are large distortions in the market system.\textsuperscript{31} 

There is a limit to the scope for the expansion of trade within the narrowly defined Central Asian region. All five countries export primarily a limited range of commodities with substantial overlapping among them. Kyrgyzstan exports mainly gold and electricity; Tajikistan electricity, cotton and aluminum; Turkmenistan cotton and natural gas; Uzbekistan cotton and gold; and Kazakhstan mainly oil and metal products. The countries’ economies are more competing than complementary, with the exception of certain specific resource complementarities (i.e. oil and coal in Kazakhstan, natural gas and cotton in Turkmenistan and Uzbekistan and hydropower resources in Kyrgyzstan and Tajikistan).\textsuperscript{32} Even in the sphere of energy the Central Asian states have focused on import-substitution strategies at the expense of regional trade.\textsuperscript{33}

Poor land, rail and air connections within the Central Asian region, combined with the large number of dispersed settlements, have been a major constraint on intraregional trade. Yet geographical and other natural limitations are by no means the only impediments to regional cooperation. Protectionist trade policies have exacerbated an already heavy dependence on commodities as the main exports, making the region vulnerable to commodity price shocks. In addition to their dependence on a particular commodity or group of commodities for export, the Central Asian economies are to a large degree dependent on a small group of producers. In Tajikistan, for example, a single plant, the Tursunzade aluminum factory, accounts for nearly half of the country’s foreign revenues. As one economist has pointed out, the Central Asian presidents have acquired ‘monopolistic control over key imports and enterprises, a lucrative perk quite at variance with the notion of regional free trade and transparent capital movement.’\textsuperscript{34}

Uzbekistan and Turkmenistan in particular have erected a number of artificial barriers to the flow of goods and people. It is notable that those two states have virtually no non-resource-based trade with the other Central Asian countries,

\textsuperscript{34}Ibid., p.45.

63
while exports from more liberal Kazakhstan and Kyrgyzstan are relatively well diversified, including agricultural products and some manufactured goods in addition to natural resources. Uzbekistan and Turkmenistan also score the lowest marks in terms of the non-tariff barriers to trade facilitation that they impose, particularly with regard to customs procedures, regulatory transparency, the operation of transport services and corruption practices. The strengthened border regimes in Uzbekistan, which shares a border with every other Central Asian states, have affected the development of the entire region and have hit Kyrgyzstan and Tajikistan especially hard in so far as their exports to Russia and Europe must travel through Uzbekistan. Although not nearly as significant as non-tariff barriers, the tariff rates charged by Uzbekistan approach 20 per cent: approximately twice the level of those imposed by Kazakhstan, Kyrgyzstan and Tajikistan, where they range from 5 to 12 per cent on average.

Conflicting trade policies and non-tariff barriers have inhibited the interaction of private business groups and individual traders in trans-boundary regions, stifling their potential contribution to the creation of the autonomous interstate linkages necessary for the construction of informal regionalism. Economic policies in Uzbekistan and Turkmenistan in particular have discouraged the establishment of small and medium-sized enterprises, thereby impeding the formation of an indigenous business class that would have a natural interest in trade with neighbouring states.

In Uzbekistan, little more than one per cent of small and medium-sized enterprises were engaged in foreign trade in 2003, although this percentage could rise somewhat as a result of the official achievement of a convertible currency in October 2003. Furthermore, in mid-2002 the Uzbek government imposed exorbitant taxes on private imports, effectively bankrupting the country’s shuttle traders and destroying many small businesses engaged in wholesale trading.

---

Although the Central Asian market is not itself large enough to support a significant degree of intraregional trade specialization, the picture changes significantly when the definition of the region is widened to include Russia, China and Iran as well as other non-CIS neighbours. According to one group of economists studying Central Asia, 'it is the liberalization of trade relations in this wider region that should lie at the heart of a strategy of increased integration into the world economy for the countries of Central Asia.'\(^{39}\) However, the potential to expand trade within this larger region renders the problem of high transport costs all the more salient. The transportation and pipeline network in Central Asia was part of the larger Soviet infrastructure which was geared first and foremost towards Russia, with the result that the Central Asian States are only poorly connected to industrialized market especially in South and East Asia. Moreover, the lack of access to an open sea has meant that the Central Asian countries must rely on transit through third countries to access wider regional and world markets. To the further detriment of regional economic cooperation, already high transportation costs are artificially increased by stringent transit regulations, unofficial payments, arbitrary delays and cumbersome border controls.\(^{40}\)

### 2.7 Trade Policies and Barriers

Although the Central Asian countries had very similar trade policy regimes at the time of their independence, their regimes have diverged significantly since then. Kazakhstan and Kyrgyzstan have been liberalizing their trade policies more or less steadily since early 1990s. Tajikistan liberalized its trade regime fairly rapidly after the end of its civil war in 1997. Turkmenistan has undertaken little trade liberalization. Uzbekistan liberalized its trade regime considerably in the first half of the 1990s, but this has been partly reversed since then. Consequently, trade policies today range from being very liberal in Kyrgyzstan and Tajikistan to fairly liberal in Kazakhstan to quite restrictive in Turkmenistan and Uzbekistan.

Despite formal initiatives and ambitious pronouncements, few improvements in regional trade ensued. It has been primarily the result of prevalence of both formal as well as informal barriers to trade. There were two types of formal barriers to

---

\(^{39}\) Graph et al., The Importance of Good Neighbours: Regional Trade in Central Asia', p.117.

trade: imports tariffs, and additional state regulations pertaining to trade flows. Contrary to their commitments at TAS summits, each state adopted its own unilateral tariff structure. Kazakhstan, Kyrgyzstan and Tajikistan developed relatively liberal tariff structures, while Uzbekistan opted for high tariff levels.

Tariff rates are fairly low and uniform in Kyrgyzstan and Tajikistan. Kazakhstan has a rather complex tariff schedule (with 10 ad valorem and seven specific tariff rates, and some goods been subject to both), but a relatively low non-weighted average rate. In Uzbekistan, the tariff schedule is not as complex as in Kazakhstan, but the non-weighted average rate is almost twice as high.41 In Turkmenistan, tariffs ranging from 10 per cent to 100 per cent are applied to 94 commodities when they are imported by legal entities. Imports by individuals in amounts up to $500 are exempt from tariffs. Above this amount, a uniform tariff of five per cent applies. A major problem in all the countries is that changes in tariff schedules have been frequent and unpredictable. There has been an escalation of tariffs- a rise in rates with higher degrees of processing- more so in Kazakhstan, Turkmenistan and Uzbekistan than in Kyrgyzstan and Tajikistan.

### Table 12
Average import tariffs (in per cent)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kyrgyzstan</td>
<td>11.0</td>
<td>11.0</td>
<td>9.2</td>
<td>5.2</td>
<td>5.2</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>5.0</td>
<td>5.0</td>
<td>8.0</td>
<td>8.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>21.0</td>
<td>29.0</td>
<td>29.0</td>
<td>19.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>13.3</td>
<td>13.3</td>
<td>7.8</td>
<td>7.9</td>
<td>7.9</td>
</tr>
</tbody>
</table>


### Table 13
Tariffs in selected Central Asian Countries (as of August 2005)

<table>
<thead>
<tr>
<th></th>
<th>Kazakhstan</th>
<th>Kyrgyzstan</th>
<th>Tajikistan</th>
<th>Uzbekistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of tariff rates</td>
<td>10</td>
<td>5</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Maximum rate (%)</td>
<td>100.0</td>
<td>15.0&lt;sup&gt;b&lt;/sup&gt;</td>
<td>15.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Non-weighted average</td>
<td>7.6</td>
<td>5.1</td>
<td>7.5</td>
<td>14.6</td>
</tr>
<tr>
<td>rate (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Asian Development Bank estimates.

<sup>a</sup>Ad valorem tariffs only

<sup>b</sup>Excluding a 30 per cent seasonal tariff on refined sugar.

Note: Information for Turkmenistan is fragmentary and has therefore been omitted.

---

Apart from tariffs, some Central Asian countries impose other taxes on imports that are not levied on domestically produced goods or that have higher rates for imported than domestically produced goods.\textsuperscript{42} In Kazakhstan and Turkmenistan, for instance, excise taxes are imposed on both imported and domestically produced alcoholic beverages and tobacco products, but the tax rates are higher for the former. In Uzbekistan, excise taxes are levied on a wide range of imported consumer products, but not on domestically produced ones. Certain commodities, such as construction materials, are subject to the value-added tax when they are imported but exempt when they are domestically produced. Non-food products imported to Uzbekistan from neighboring countries without a certificate of origin, but not necessarily originating in those countries, are subject to a 20 per cent surcharge.

Explicit taxes on exports are less common in Central Asia than taxes on imports, and there are no explicit export subsidies. Only Kazakhstan levies export taxes on a limited number of goods when they are exported to countries that are not members of the EEC. In some Central Asian states, export prices of certain commodities are set administratively. In Tajikistan, for example, raw materials are exported at the prices prevailing at the republican commodity exchange, but taking into account world prices. In Turkmenistan, natural gas and electricity are exported at prices set in intergovernmental agreements.

Some of the Central Asian countries concluded bilateral free trade treaties among themselves (outside of the TAS framework) that stipulated duty-free bilateral trade. In addition, Kazakhstan and Kyrgyzstan formed a customs union in 1995 with Belarus and Russia, where they committed themselves to remove import tariffs. Tajikistan joined the customs union in 1999.

Table 14
Bilateral Free Trade Agreements

<table>
<thead>
<tr>
<th></th>
<th>Kyrgyzstan</th>
<th>Tajikistan</th>
<th>Uzbekistan</th>
<th>Kazakhstan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kyrgyzstan</td>
<td>-</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>No</td>
<td>-</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Yes</td>
<td>No</td>
<td>-</td>
<td>No</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>-</td>
</tr>
</tbody>
</table>


However, these bilateral treaties and the customs union opened the way for unspecified potential exemptions, temporary protections and anti-dumping measures. Some treaties were from the outset accompanied by side protocols specifying exemptions for certain goods.

Both Uzbekistan and Kazakhstan had additional taxes on imports that were not levied on domestically produced goods. In Kazakhstan, the coverage of excise taxes on imported goods and domestically produced goods was identical, but the rates of the former were considerably higher. In Uzbekistan, a wide range of imported products were subject to excise tax, but similar goods produced domestically were exempt. These goods included: ice cream (200 per cent excise tax), mineral water (100 per cent), most types of juices (70 per cent), poultry meat (70 per cent), cheese (50 per cent), yogurt (50 per cent), plastic tableware and kitchenware (50 per cent) and soap (20 per cent).

The extensive use of temporary measures made the trading environment uncertain and less conducive to long-term planning. Temporary measures were particularly prevalent during the 1998 Russian financial crisis. In 1998 and 1999, both Uzbekistan and Kazakhstan introduced several additional temporary measures. In April 1999 Uzbekistan increased the number of goods subject to special licences (pod aktsizm), which entailed additional taxes of 10 to 100 per cent of the value of these goods. Similarly, in February 1999 Kazakhstan raised its import duties (poshlina) on goods from Kyrgyzstan and Uzbekistan. According to Vechernii Bishkek, these measures increased by 100-200 per cent the import prices of common Kyrgyzstani and Uzbekistani export goods like rice, flour, margarine, alcohol, tobacco and cement. Kazakhstan’s Minister of Trade, Industry and Energy, Mukhtar Abliasov, explained these measures as follows: ‘In the conditions of currency devaluations in practically all of our CIS neighbours we are put at risk of having all our industrial production disappear.’ He stressed that with the new

---

46 Hoekman and Kostecki, *The political economy of the world trading system*.
measures Kazakhstan could maintain the competitiveness of its producers, while at the same time ‘money would be earned for the state budget.’

Kazakhstan later abolished some of its additional 1999 tariffs on imports from Tajikistan and Kyrgyzstan. Uzbekistan, however, retained much of its complicated system of high levies.

Frequent border closures by Uzbekistan also made trade more difficult. The border with Tajikistan was kept closed throughout most of the late 1990s, and commercial air traffic between Dushanbe and Tashkent was banned, ostensibly in an attempt to halt drugs smuggling and guard Islamic extremism. In 2002 Uzbekistan temporarily closed its border with Kazakhstan and Kyrgyzstan—according to the UNDP, ‘officially to protect against an epidemic, but in fact also preventing people from visiting, shopping, or working in the neighbouring countries.’

Export from the four Central Asian states to neighbouring countries and elsewhere have been subject to extensive certification rules. Tajikistan, for example, continued to use the comprehensive system of mandatory standards from Soviet days. The World Bank, however, argued that Tajikistan was unable to properly administer such a system, which ‘requires well-equipped laboratories, highly qualified staff and effective enforcement.’ This disjuncture caused delays and increased opportunities for rent-seeking among government officials. Bribes usually helped speed up the certification process.

All countries apply quantitative restrictions, such as prohibitions, quotas and licenses, to trade in goods that have implications for national security, public health and the environment, or are deemed to be against social norms. In Kazakhstan, in the 1990s there were more than 1000 laws, instructions, decrees and orders issued, amended or overruled, all relating to various specific aspects of customs regulation. Some Central Asian countries use quantitative restrictions for economic and social purposes. Turkmenistan and Uzbekistan restrict imports of certain products or their substitutes from foreign competition. Turkmenistan and Uzbekistan also prohibit exports of some food products to ensure their availability in the

48 Ibid., 2 February 1999.
50 Ibid.
52 Ibid.
53 L. Annozvazi-Jakab, ‘Cross-border trade facilitation issues in the Central Asian region’.
domestic market at relatively low prices. For the same reason, Kazakhstan temporarily prohibits exports of diesel fuel and fuel oil during harvesting and heating seasons, respectively.

Some Central Asian countries also use registration of international transactions as means to regulate trade. In Turkmenistan, all exports and import contracts for all goods—with the exception of export contracts for strategic commodities, such as natural gas, oil and oil products, electricity and cotton—are subject to ex ante registration with the State Commodity Exchange. Export contracts for strategic commodities require ex ante approval of the Cabinet of Ministers. In Uzbekistan, import contracts financed from the state budget or government guaranteed credits or enterprises that are more than 50 per cent owned are subject to ex ante registration, while all other import contracts by legal entities are subject to ex post registration.

Both licensing and registration of international transactions create opportunities for rent-seeking, and can fuel corruption and hinder international trade. Licensing of the export and import of some products appears to be primarily intended to create or preserve monopolies. Unfavorable foreign exchange and payment regulation in some Central Asian countries create additional impediments. In Turkmenistan, restricted access to foreign exchange constitutes a major obstacle to imports, while the requirement that certain categories of exporters surrender part of their foreign exchange earning at the overvalued exchange represents an implicit tax on their exports. Some categories of importers reportedly continue experiencing difficulties in purchasing foreign exchange in Uzbekistan even after the country introduced full convertibility of its national currency for current international transaction in October 2003. In Tajikistan, a regulation requiring a 100 per cent prepayment for exports of a wide range of products makes exporting these products more difficult.

The Central Asian countries need to make considerable improvements not only in their trade regimes, transport, border management, customs administration and transit systems, but also in behind-the-border conditions for business and finance if they are to expand trade and investment and promote human development

---

and human security. A supportive business environment and access to finance, not only for large urban firms, but also for smaller and micro-enterprises, including rural areas, make it possible for people to respond to improve trade opportunities by increasing the production of tradable goods and services.

Currently, there are major obstacles to private business and finance in Central Asia, including barriers to market entry, underdeveloped financial sectors, and the lack of marketing institutions and skills. Much external economic activity is subject to licensing, and in most of the countries, state-owned companies monopolize the export of key commodities, such as energy products, precious metals and cotton fibre. Financial services and instruments facilitating international trade, such as short-term credit, insurance letters of credit and bills of exchange, are not readily available. There are few specialized marketing companies, and exporters often lack skills and other resources necessary for marketing their products abroad. Business have limited information about export and import opportunities existing in other countries, while business in other countries often lack information about similar opportunities existing in Central Asia.

A number of studies conclude that region-wide political and economic stability resulting from regional cooperation and integration could have a positive effect on investment in general and on FDI in particular. From the point of view of foreign investors, regional considerations can be even more important than national ones. In addition to objective factors, such as an increase in the market size resulting from cooperation, the subjective image of the region may play a crucial positive or negative role in investors' decisions. Economic theory and numerous empirical observations confirm that negative signals from one country, whether political, economic or social, spill over and inform impressions of neighbouring countries.

Despite strong political declaration placing investment and an improved investment climate among the highest national priorities, and despite some progress in this regard, businesses and investors—including foreign investors—encounter numerous difficulties in Central Asia. Surveys conducted in the region and

57 Questionnaire by the UN Industrial Development Organisation in Kyrgyzstan, 2003.
discussions with entrepreneurs confirm several fundamental obstacles. Each slows down or blocks business development.

Barriers to business entry remain high in terms of the number of procedures, time required, cost and minimum required capital. Heavy burdens from state control and complex business regulations remain virtually unchanged, even where there have been reforms in business registration and approval processes. The procedures for obtaining licenses and permits remain complicated, forcing entrepreneurs to collect a large number of supporting documents, seals and signatures from numerous institutions. Time-consuming contract enforcement processes present additional obstacles. According to a recent World Bank assessment, the complexity of procedures and the burden of time spent with state officials (the so-called ‘time tax’) in Central Asia is above the average for all transition economies and developed countries.

Direct intervention in business operations by representatives of various official institutions and multiple layers of corruption in political and economic structures are widespread. According to the Business Environment and Enterprise Performance Survey, more than 30 per cent of firms need to make bribes frequently. Around 3.3 per cent of annual firm revenue is soaked up by unofficial payments (this compares to the CIS average, but is almost twice the EU-8, or new post-communist EU states, average of 18 percent of firms making bribes, and 0.9 per cent of revenues spent on unofficial payments). The average bribe tax in the region has been estimated to be around five per cent; in Kazakhstan, Kyrgyzstan and Tajikistan more than one-half of the firm reported paying at least some bribes (in Uzbekistan this number is just below 50 per cent). Other regional problems include delays in contract enforcement and losses from crime. Unfortunately, worldwide experience shows that once inefficient government, discretionary interventions and corruption have become endemic, it is very difficult to root them out. Nonetheless, it is important that improvement be made, since without them a poor business environment and investment climate will

59 Ibid.
prevail, hampering domestic and foreign investment along with trade, growth and employment creation.

Another important area is to strengthen financial systems. With the right policies in place, this process can be both pro-growth and pro-poor. A growing private sector and the development of trade and commerce, both domestic and trans-border, require a healthy financial sector that can provide the capital or business to invest and trade. An efficient financial sector mobilizes resources and allocates them to those investments that are capable of generating the highest returns. Developed and competitive financial intermediaries will foster economy-wide competition and openness by facilitating the entry of new enterprises and reducing the dependence on personal wealth and political connections.63 Improved access to finance is of critical importance particularly to small, medium and micro-business as well as the self-employed, which make up the majority of those employed in both the formal and informal sectors in most Central Asian economies.

As in the case of measures to improve the business environment and investment climate, financial sector reforms are mostly a matter of national action. However, here too there are benefits from a regional perspective and regional cooperation. First, with the countries facing similar financial sector weaknesses and institutional shortcomings, regional cooperation would encourage the sharing of experiences, best-practice reforms, benchmarks of progress and the expertise of technical experts in the region and around the world.

Second, comparable and consistent regulatory practices will help forge cross-border banking sector links, unleash FDI flows, improve cross-border payment mechanisms (e.g., for export and imports, and also for migrants’ remittances) and in general integrate economic activities for mutual benefit. Recently, illicit cross-border financial flows, especially money laundering, have sparked international concern. Only regional and global approaches to combat these problems have any hope of success.

Third, there are so-called ‘contagion effects’ that can cut across borders and are mediated by financial sectors. For example, when there is a banking sector collapse in one country, this may spread to neighbouring countries, as was

demonstrated very painfully in Central Asia in the wake of Russia’s 1998 financial crisis.64

At independence, the Central Asian countries had to create functioning financial systems where none had existed before. Transition has ushered in financial development through new roles for central banks, restructuring and privatization of state-owned banks, and the development of commercial banking systems and non-bank financial institutions. While there has been progress, financial systems remain poorly developed even by low CIS standards. Substantial reforms are needed in most countries, especially in the banking sector, given its overwhelming importance in Central Asia relative to other financial institutions. Improved banking regulation, supervision and enforcement; privatisation of state banks; increased competition among banks and easier entrance for foreign banks are among the key steps countries need to take.

Despite important similarities among the Central Asian countries, they are at different stages of financial sector development, and have varying needs and priorities. Kazakhstan has made significant progress in reforming and developing its financial sector and is at a much more advanced stage than the other four countries.65 Recently, Kyrgyzstan has also advanced the reform and strengthening of its financial system. Tajikistan is forging ahead after its civil war, but many challenges remain. The financial sectors in Turkmenistan and Uzbekistan are underdeveloped and lag behind the other countries. The Uzbek Government maintains tight reins on most of the financial sector, which is dominated by state-owned banks. Turkmenistan’s financial system is small and mainly state controlled.

While the banking sectors have been developing gradually in Central Asia, non-banking financial intermediaries are growing rapidly, helping the financial system provide access to more vulnerable groups. Although they are still in their infancy, non-banking financial services, such as leasing, microfinance, rural finance and migrant remittance flows, can make a significant difference to ensuring access to finance to otherwise commonly excluded businesses and population groups. Given Central Asia’s widespread poverty and the prevalence of very small, often


74
informal business, access to microfinance and hence the development of microfinance institution is of special importance.\textsuperscript{66} Some Central Asian countries have initiated national programmes for microfinance reforms; external donors have provided support on regional basis.

The microfinance industry is still at an early stage of development, but it is now the fastest growing segment of financial markets in the region. Among transition economies, Central Asia perform relatively well in this sector. Some of the leading microfinance institutions have achieved impressive financial performance. However, demand for finance by far outstrips supply due to factors that include the overall weaknesses of banking sectors, and continued institutional weaknesses such as the lack of training and technical skills.

A special challenge for the financial sector as a whole is the development of capital markets as sources of long-term capital investment, including more stable flows of FDI. Capital markets encourage more publicly available information and its disclosure, thereby leading to better governance. Since capital markets in Central Asia remain underdeveloped, firms rely mostly on internal finance and credits, with very little access to equity finance. Trading is concentrated on the Kazakhstan Stock Exchange, mostly in foreign exchange, repurchase agreements and government debt instruments. Kyrgyz Stock Exchange trading is minimal, and capital markets remain a small part of the financial sector.\textsuperscript{67} In Tajikistan and Uzbekistan capital markets are virtually nonexistent. The republican Tashkent Stock Exchange is extremely small, and the securities traded include a limited number of publicly listed companies and short-term government securities. Devising a regional approach to capital market development may be the quickest way to ensure that more firms have access to equity finance.

Like other regions of the developing world, the approaches of Central Asian Republics to economic development hinges on the political processes in the region. Thus interstate economic cooperation is sometimes held hostage to the political and security considerations. Various theories on international cooperation state that meaningful economic cooperation involves some kind of sovereignty being

\textsuperscript{66} World Bank, "Central Asia Microfinance and the Poor", "Poverty Reduction and Economic Management Unit, Europe and Central Asia Region, Washington DC, pp.6.

\textsuperscript{67} World Bank, "Kyrgyz Republic: Financial Sector Assessment." Washington DC.
compromised or traded-off in the larger interest of relative economic gains. However, in the context of Central Asia this argument has not found favour among the regional leaders. Consequently, conflicting national interests remain the main factor behind the muddled process of interstate cooperation in the sphere of economy. However, despite this all the Central Asian Republics have committed themselves to the common political and strategic goals which are the focus of enquiry in the next chapter of the present work.