

REGIONAL POLITICS

**REGIONAL COOPERATION
IN CENTRAL ASIA
AS SEEN FROM UZBEKISTAN**

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(Tashkent, Uzbekistan)**Introduction*

The UNDP report for 2005¹ described the Central Asian economies of Soviet times as closely connected with the rest of the Soviet Union at the expense of their cooperation with the outside world. There is the opinion that the considerable investments of the Soviet period in physical infrastructure and human capital have somewhat improved the standard of living in this part of the Soviet world. The improvements, however, arrived with devastating effects on the environment and the region's culture.

In 1991, the new states (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uz-

bekistan) with a total population of about 60 million rose from the ruins of what was once called the Soviet Union. The squabbles among some of these Soviet successor-states undermined regional trade and damaged the water and energy systems.

Here I have undertaken an analysis of two important aspects of regional cooperation—trade and energy—using Uzbekistan and Tajikistan as examples. The main question is: What is interfering with closer regional cooperation in both fields and what should be done to improve the situation.

To move forward the Central Asian economies should use their advantages and turn them into development factors:

- (a) the communicational, transportation, and energy infrastructure inherited from

¹ See: *Central Asia Human Development Report 2005* by the UNDP Regional Bureau for Europe and the Commonwealth of Independent States, Bratislava, Slovak Republic, 2005.

- the Soviet Union makes a coordinated regional approach indispensable;
- (b) ecological problems call for concerted regional efforts;
 - (c) the region's potential attractiveness for foreign and local investors who would rather operate in regions free from trade and transit barriers than in small and limited economies;
 - (d) regional cooperation is badly needed to move to the world markets to promote the region's further integration into the world economy.

After looking into two aspects of regional cooperation (trade and energy), I discovered that the road toward wider cooperation was blocked. In regional trade:

- The ability to cooperate with neighbors depends on the development level of the country's market economy and the mechanisms of democratic administration. So far, these factors remain undeveloped in Central Asia, which interferes with successful regional cooperation;
- Different economic strategies result in different trade policies, which interferes with regional cooperation;
- The Regional Trade Agreements among the Central Asian republics normally

apply to a very limited range of commodities and are too complicated with respect to the commodities' origin. For these reasons the majority of them remained on paper;

- The trade barriers are too high, while protectionism is too severe: customs tariffs are relatively low, while the Central Asian countries are using other instruments, often in an arbitrary and non-transparent manner, to regulate trade: additional taxes on imported products from which locally produced goods are exempt or at least much higher tax rates than those applied to local products, a ban on the export of certain categories of goods, etc;
- The level of trade complementarity among the Central Asian republics is very low.

In the energy sector:

- The Uzbek and Tajik governments tend toward self-sufficiency, a policy that limits or even undermines potential cooperation;
- The distorted system of energy prices does nothing to promote greater cooperation between the two countries; and finally
- Payment defaults.

Regional Cooperation: Benefits and Advantages

There is an agreement among those who specialize in the international economy that trade is almost always mutually advantageous. Krugman and Obstfeld have written: "The range of circumstances under which international trade is beneficial is much wider than most people imagine."² Textbooks on the international economy are zealously driving home the idea that mutually beneficial trade is possible between a more efficient and a less efficient country, whereby the producers of the latter

² P.R. Krugman, M. Obstfeld, *International Economics: Theory and Policy*, 6th edition, Addison-Wesley, 2003, p. 3.

remain afloat only by paying lower wages. This fully applies to Central Asia: the five landlocked Central Asian countries may profit if and when they remove the barriers to the free movement of people, goods, and knowledge inside the region and throughout the rest of the world.

The UNDP report for 2005 states that greater cooperation among the Central Asian republics will produce greater gains by reducing trade costs, increasing remittances from migrant workers, and improving water and energy use. The experience in other parts of the world proves that regional cooperation helps to fight poverty, while the absence of cooperation makes the poor even poorer. The UNDP report points out, among other things, that opening up borders or reducing trade costs is not enough. Much depends on the business climate and the quality of financial services. Indeed, international experience has confirmed that corruption should be uprooted and the civil service improved, while the governments should become more transparent and more open. Martin Spechler writes that civilian machine-building should be revived together with open access to neighboring markets—otherwise it makes no sense.³ The Asian Development Bank has pointed out that to achieve sustainable economic development of their relatively small economies, the Central Asian republics should promote trade and close integration into world trade.⁴ As a landlocked region far removed from the major seaports, Central Asia should concentrate on regional cooperation to a much greater extent than other regions of the world. This means that the Central Asian countries should serve as transit territories for their regional neighbors wishing to reach major seaports. Trade inside the region is another option that cuts down transportation costs needed to move goods to rich yet remote markets.

There are numerous “non-economic” factors which facilitate regional cooperation: linguistic and cultural similarities, as well as Islam as the shared religion. In pre-Soviet times, the “-stans” remained practically undivided, which means that the local nations have a common past as well.

Multilateral institutions, donor agencies, bilateral aid programs, and a number of other regional organizations are doing a lot to promote regional cooperation, but many observers have to admit that the post-Soviet progress toward regional integration has been very modest. There are barriers that interfere with trade in general and trade in electric power in particular; there are also obstacles of an “institutional” nature that negatively affect regional cooperation as a whole. The UNDP report for 2005 points out in this respect that “a country’s ability to cooperate fully with its neighbors depends on the nature of its internal institutions, regulatory system and governance culture. A nation with sophisticated market institutions is better able to engage in regional economic integration. A country with a more open, and democratic culture can build stronger cross-border ties than one with a less open, more autocratic political culture and institutions.”⁵

Regional Trade Cooperation

As part of the Soviet Union, the Central Asian republics were part of the all-Union Moscow-managed trade process that most of the time ignored resource efficiency, pricing, and transportation

³ See: M. Spechler, *Regional Cooperation in Central Asia: Promises and Reality*, Indiana University-Purdue University Indianapolis, 1998, p. 4.

⁴ See: *Central Asia: Increasing Gains from Trade Through Regional Cooperation in Trade Policy, Transport, and Customs Transit*, Asian Development Bank, Philippines, 2006.

⁵ *Central Asia Human Development Report 2005*, p. VI.

costs normally taken into account in market economies. Moscow was responsible for foreign trade too. It was only as independent states that the Central Asian republics and their products acquired access to the world markets. As parts of the Soviet Union none of the Central Asian countries could control its economy and foreign trade. Kazakhstan's government, for example, says that before 1991, 90 percent of its industry was controlled by the Moscow-based ministries, which means that as an independent country Kazakhstan lacked the expertise needed to shape and develop industrial policies, run state-owned enterprises, and be engaged in foreign trade.⁶ This means that Uzbekistan and its Central Asian neighbors had to create sovereign states and set up state bodies to control their national economies⁷ before starting their reforms and finding their places on the world market. The process was slowed down by the practically non-existing ramified transportation infrastructure and trade contacts, as well as by the limited competitiveness of local products on the world markets and the weak local currencies. Some of these obstacles were removed; some of the limitations were partly removed, which largely decreased (according to the UNDP report for 2005) the share of the former Soviet republics in the Central Asian countries' trade.

Harmonized trade and customs regulations, open borders, and better cooperation in power production and the use of natural resources will bring the greatest benefits to each of the countries. My interviews with several existing and potential foreign investors in Uzbekistan revealed that the country's, and the region's for that matter, attractiveness for foreign investors could have been much higher had the region been a single economic area without borders, visas, and customs barriers. The interviewed investors pointed out that Central Asian trade as well as the region's trade with the rest of the world suffered because of protectionism, difficulties on the borders, the visa regime, and transportation problems. The interviewed businessmen, in turn, pointed out that region's 60-million strong consumer market looked much more attractive and made more sense than the fairly limited markets of each of the Central Asian countries.

The ADB report⁸ points out that in Central Asia, which is a landlocked region, liberalization of trade policy and regional cooperation in transport and customs sphere are mutually dependent issues. Progress in any one of these areas will produce but a limited positive effect in the absence of progress in the other spheres. Liberalization of trade policy, for example, in Central Asia and the neighboring states, will do next to nothing to boost bilateral trade in the limited transit systems or in the absence of a developed transportation infrastructure that will hamper the movement of transportation means and commodities.

The Table shows that the share of intra-regional trade in the foreign trade of the Central Asian republics is relatively small; we should bear in mind, however, that a larger part of intra-regional trade remains unrecorded.

The Table shows that the smaller Central Asian economies (the Kyrgyz Republic and Tajikistan) are more dependent on regional trade than the larger economies (Uzbekistan and Kazakhstan).

The UNDP 2005 report points out that trade between the Central Asian countries remains relatively limited even though the countries have somewhat restored their economies compared with the early independence years. Statistical error is not excluded: regional trade is less carefully recorded than foreign trade, but the actual level of intra-regional trade is low. The ADB explains this by the low trade complementarity level and trade barriers. Kazakhstan, for example, can potentially

⁶ See: J. Henley, *Restructuring Large Scale State Enterprises in the Republics of Azerbaijan, Kazakhstan, the Kyrgyz Republic and Uzbekistan: The Challenge for Technical Assistance*, University of Edinburgh, Edinburgh, 1995.

⁷ See: B. Islamov, "State-Led Transformation and Economic Growth in Central Asia: From Plan to Industrial Policy," *Hitotsubashi Journal of Economics*, No. 39 (2), December 1998, p. 102.

⁸ See: *Central Asia: Increasing Gains from Trade Through Regional Cooperation in Trade Policy, Transport, and Customs Transit*.

**Share of Intra-Regional Export and
Import of the Central Asian Republics,
1999-2004**
(percentage of total merchandise exports/imports)

Country (export/import)	Year					
	1999	2000	2001	2002	2003	2004
Kazakhstan (export)	3.4	3.3	4.3	3.8	3.7	4.2
Kazakhstan (import)	3.6	2.3	2.0	2.1	2.0	2.6
Kyrgyz Republic (export)	22.6	26.6	20.1	16.6	16.2	17.5
Kyrgyz Republic (import)	27.1	24.6	32.2	32.4	29.8	27.4
Tajikistan (export)	27.5	13.6	14.2	10.9	9.5	8.1
Tajikistan (import)	55.2	50.2	40.6	34.8	36.1	37.8
Uzbekistan (export)	9.7	8.3	9.2	8.0	6.6	10.6
Uzbekistan (import)	6.7	11.7	8.8	8.3	8.1	7.5

Source: Asian Development Bank.

absorb a relatively large proportion of the exports of Kyrgyzstan and Tajikistan and increase its share in their import, both countries are responsible for tiny fractions of Kazakhstan's import and export operations. The profiles of Kyrgyz imports and Tajik exports have very little in common, which means that these countries may find more trade possibilities with distant, dissimilar, and hence complementary economies, if they can overcome the barriers on their way to the world markets. Regional trade and trade with the rest of the world will depend on regional cooperation, which may reduce trade costs.

Cooperation between Uzbekistan and Tajikistan in the Energy Sector

Today Uzbekistan is still Central Asia's largest power producer and net exporter with a total installed generation capacity of 12,300 MW or about 50 percent of the power-generating facilities of the Integrated Power Grid of Central Asia. The branch produces up to 48 billion kWh of energy and over 10 million Gcal of heat energy every year.

To ensure energy supply to the industrial and housing sectors and to create favorable conditions for the country's sustainable and effective development, the power-generating facilities of Uzbekenergo should be increased and reconstructed.

The Tajikistan Energy System's installed capacity is 4,354 MW. The annual average power generation of the hydropower plants is 15-17,000 Gcal. The Nurek hydropower plant with 3,000 MW installed capacity, the biggest in Central Asia, has a seasonal-storage reservoir and operates in the irrigation regime at the beginning and in the middle of the growing season to satisfy the needs of Kazakhstan and Uzbekistan. This means that Tajikistan has to buy energy from Uzbekistan, Turkmenistan, and Kyrgyzstan; its energy system suffers of winter shortages and summer surpluses within the range of 1 to 1.5 kWh. The Soviet system of energy exchange is no longer viable: under Soviet power the republics that shared the Amu Darya's water were involved in water and energy transfers directed, as many other things, from Moscow. Tajikistan received Turkmenian and Uzbek gas in exchange for electricity produced in the summer, as well as electric power from Uzbekistan in the winter. In the post-Soviet years, the countries replaced the old barter system with trade, which means that Tajikistan has to import energy and gas from Uzbekistan. The UNDP 2005 report has pointed out that during the years of independence, the Soviet water and energy exchange arrangement was undermined by the local nations' divergent interests. Kyrgyzstan and Tajikistan, the upstream countries, use the water of the Amu Darya and the Syr Darya (two main regional rivers) for generating electricity, especially in winter. The downstream countries (Kazakhstan, Turkmenistan, and Uzbekistan) prefer to have maximum access to water for irrigation in the summer months; they try to avoid the floods caused by winter water releases. To cope with the diverse interests, the Central Asian governments concluded bilateral and multilateral agreements that determine the quantities and costs of the exchanged water and energy resources (coal, electricity, and gas).

Bilateral trade, however, is not proceeding smoothly: in the past, Uzbekistan cut gas supplies to Tajikistan in an effort to force it pay its gas debts; in addition, gas supplies from Uzbekistan are faulty because of low pressure in the pipelines.

In an effort to reduce its energy dependence on Uzbekistan, Tajikistan is currently looking into the potential of its huge hydropower resources: today, only 10 percent of them are used. The republic is actively working on two hydropower projects started in Soviet times and abandoned in the post-Soviet period. According to former minister of energy of Tajikistan Nurmakhmatov, capital investments of about \$2 billion into the Rogun and Sangtuda hydropower stations will allow the country to export at least 10 billion kWh every year in the next 5 to 7 years. These stations will increase operational power generation in Tajikistan to an annual level of 31-33 billion kWh. Uzbekistan is not happy: if implemented these projects might decrease the amount of irrigation water that reaches the republic every summer.

This means that closer regional cooperation, which will lower the prices, is highly advantageous and badly needed: Kazakhstan and Uzbekistan, for example, will be able to buy power generated by the existing hydropower stations of Kyrgyzstan and Tajikistan in the summer at lower prices, rather than generating power at their thermal power stations at much higher costs. This calls, however, for much greater transparency in the energy sectors of all the countries.

In fact, Central Asia's energy export potential is sufficiently high: it may sell its energy to Pakistan and Iran, where the demand for energy reaches its highest in the summer. This coincides with the peak power production in Central Asia. Kyrgyzstan and Tajikistan may profit from this more than their neighbors; Uzbekistan and, to some extent, Kazakhstan can export thermal energy in the winter, and profit as transit countries and energy traders. The World Bank Report of 2004⁹ suggests that the Central Asian republics should conclude an intra-regional agreement on power transit to gain access to the export markets. New major power-generating projects in Central Asia will only be profitable if the producers gain access to extra-regional export markets.

⁹ See: *Central Asia Regional Electricity Export Potential Study*, Europe and Central Asia Region, The World Bank, Washington, DC, 2004. Mimeo.

In 2001, the ADB allocated a loan for a Regional Power Transmission Modernization Project to promote regional cooperation in the power sector on the condition that Uzbekistan and Tajikistan sign a new type of power trade agreement.¹⁰ The agreement, however, was never approved and the loan was cancelled.

The power trade agreement fell through together with the loan because:

- There was no financial framework to be used to settle those transactions which involved money (U.S. dollars) rather than barter;
- There were no bank guarantees for the dollar-based transactions, which would have created problems with currency exchange;
- There were fears that the sides might fail to pay;
- The sides obviously preferred to protect their energy security.

C o n c l u s i o n

The UNDP report for 2005 says that no consensus and no follow-up actions conducive to regional cooperation and integration can be achieved overnight. Noticeable progress in regional cooperation and integration might take years, and even decades, to be completed: there are too many obstacles of a political and institutional nature on the way. We all know that similar efforts elsewhere in the world required much time.

To achieve regional cooperation in Central Asia we should concentrate on improving the trade regime in the local countries and coordinate them with their movement toward WTO membership; the market economy and democratic institutions should receive their share of attention, while trade and customs policies should be harmonized; and trade barriers (additional taxes on imported goods from which local products are exempt, higher tax rates for imported goods, and bans on some exported products) should be liquidated.

Uzbekistan and Tajikistan obviously need a strong negotiator/broker to help them come to terms in the power sector. If Russia can demonstrate its impartiality toward both sides, it could play this role. Both countries will obviously profit from cooperation in the power sphere. At the same time, they should be forced to trim their energy-related self-sufficiency somewhat, readjust the so far distorted prices, and do something about the threat of repeated failures to pay.

¹⁰ See: *Report and Recommendation of the President to the Board of Directors of Proposed Loans to the Republic of Tajikistan and to the Republic of Uzbekistan for the Regional Power Transmission Modernization Project*, Asian Development Bank, Manila, 2002, RRP: TAJ/UZB 35096.