

REGIONAL ECONOMIES

**CENTRAL ASIA:
ECONOMIC COOPERATION
POTENTIAL**

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The Central Asian republics are rich in energy resources: three of them (Kazakhstan, Uzbekistan, and Turkmenistan) can boast of oil and gas deposits, while the other two (Kyrgyzstan and Tajikistan) have vast hydropower potential. This means that harmonized energy policy designed to meet their demands in energy, energy exports, and stronger positions in ensuring international energy security makes sense.

By the same token, these countries can, potentially, develop metallurgy, machine building, and light industry as their industrial priorities. In fact, deeper integration in these fields will add efficiency to their efforts to fully tap the region's industrial potential. Integration in the agricultural sector with a view to developing, some time in the future, the common agrarian market is another local priority.

Transport is the field in which integration is even more welcome: the region's transit potential will expand the trade and economic ties among the local states and revive the Great Silk Road.

The present level of mutual trade has not yet reached the highest possible level of economic cooperation: the share of its Central Asian neighbors in Kazakhstan's trade turnover is about 0.6 percent (in 2006, Kyrgyzstan's share in Kazakhstan's trade turnover was a meager 0.7 percent; Tajikistan's share, 0.3 percent; Uzbekistan's, 1.1 percent, and Turkmenistan's, 0.2 percent).

This means that *deeper regional integration has become a priority and a factor of the local countries' faster economic growth, higher living standards, and stability.*

An analysis of the local states' social and economic development revealed that all of them have finally achieved positive rates of economic growth. In 2006, the average GDP growth rate of four of them (Turkmenistan is excluded) was 6.9 percent, while the growth rate of industrial production amounted to 3 percent.

At the same time, the level of economic development and market transformations differs from country to country.

In Uzbekistan, for example, the state has a great role to play in economic management, which should be changed to create a favorable investment climate.

In Kyrgyzstan, the fairly complicated local politics and strife among the local political groups pushes the economy and the standard of living into the background. The investment climate cannot be described as inviting.

Tajikistan and Turkmenistan are the region's poorest states. Tajikistan is burdened with enormous foreign debt; its inefficient economy cannot cope with the social problems and ensure economic growth. In Turkmenistan, the political system set up by late President Niyazov hampers democratic and market development in the country.

Kazakhstan, on the other hand, has surged ahead in its socioeconomic development, even though the country still relies on its raw-material sector and still has problems in the agrarian sphere. It remains under-funded, unable to rationally spend the budget money allocated to it and to master new technologies. The countryside and agricultural production are still in a sad state. The processing sector remains uncompetitive.

In pursuit of its ambitious aim of joining the group of the world's fifty most competitive states and integrating into world economy, the republic is working hard to diversify and modernize all the economic and social spheres.

The region's social and political instability is sending migrants to Kazakhstan, a process accompanied by an increase in crime and drug trafficking.

This means that the Central Asian countries should expand their cooperation and integrate for the sake of free movement of goods, capital, technologies, and services as well as better customs and tariff policies. Economic integration, faster market development, and more active democratic processes alone can spur on industrial growth that will create new jobs, improve the standard of living, and stabilize the situation.

An analysis of the integration processes in Central Asia suggests that regional cooperation is moving ahead: there is a legal normative basis of trade and economic ties within the region; intergovernmental coordinating councils have been created designed to promote economic cooperation (in 2006, Kazakhstan and Uzbekistan set up an Intergovernmental Coordinating Council that included heads of the corresponding ministries and departments of both countries; in 2007, Kazakhstan and Kyrgyzstan set up a similar structure); the ties with international organizations have become wider, while bilateral ties across the region are playing a much more important role than before.

On 11-12 September, 2007, during President of Kazakhstan Nazarbaev's visit to Turkmenistan, the two countries reached an agreement on their cooperation in the transport, energy, and health protection spheres. The railway between the two countries designed to connect them with Iran and the Gulf countries is high on the bilateral agenda.

The two presidents discussed the transit of Turkmenian gas across Kazakhstan to foreign markets, the Caspian Gas Pipeline project, and the involvement of Kazakhstan companies in prospecting and developing Turkmenistan's hydrocarbon reserves.

They also discussed the possibility of building a seaport and an airport in the city of Turkmenbashi and a cement plant in Turkmenistan. The president of Kazakhstan announced that his country was ready for talks on all these issues. It is expected that soon Kazakhstani banks, funds, and industri-

al companies will open their offices in Turkmenistan to promote mutually beneficial cooperation between the two countries.

On 12-13 September, 2007, during President Nazarbaev's official visit to Tajikistan, the sides discussed an agreement on setting up a Kazakhstan-Tajik investment fund with an authorized capital of \$100 million to promote cooperation between the two countries. Tajikistan is presently concentrating on hydropower production and the aluminum industry, which are expected to profit from Kazakhstani investments: their development will become more effective, while new jobs will stabilize the situation in the real economic sector.

During Premier of Kazakhstan K. Masimov's visit to Uzbekistan in July 2007, the sides looked at the future of their cooperation in the investment sphere, while Kazakhstan presented its Development Bank to demonstrate its readiness to fund joint breakthrough projects in energy production and other sectors of the real economy. If realized, they will become an important factor in the two countries' sustainable development. It should be said, however, that wider trade and economic cooperation between the two countries calls for adjustment of Uzbekistan's national legislation to the legal norms of the market economy. So far, Uzbekistan's banking legislation is interfering with the successful development of intergovernmental economic contacts. Not infrequently, businessmen find it hard to cash money and carry out other banking operations.

Kazakhstan is also making a concerted effort to add vigor to its investment cooperation with Kyrgyzstan. During President Nazarbaev's official visit to Kyrgyzstan, the sides discussed several projects in the real economic sector. Today, a joint venture among Kyrgyzstan, Kazakhstan, and Russian state companies is expected to complete two hydropower stations on the Naryn (Kambarata-1 and Kambarata-2).

During his visit, the Kazakhstan president pointed out that Kyrgyzstan should concentrate on its economic development and stabilize the social context. It should be said that in 2006 the volume of Kazakhstani investments into Kyrgyzstan's economy topped \$300 million (30 percent of the total volume of investments in Kyrgyzstan). An Intergovernmental Council was set up after the visit to deal with the issues of bilateral interest and promote further cooperation.

Today Kazakhstan is stepping up its investment cooperation with its Central Asian neighbors in their and its own interests. The country needs stability in the adjacent states as an important factor of stronger regional security and its own continued sustainable growth. An unstable economic situation across the borders might breed terrorism and extremism in the region; this should be prevented through deeper cooperation, joint projects in the real sectors of the region's economy, upgraded competitiveness of local industrial products, and higher living standards of the local nations. If realized, this will avert potential threats and contribute to the sustainable development of all Central Asian states.

We should say, at the same time, that the positive trends, notwithstanding the integration processes on the whole, are slowing down.

The problems of the rational use of the region's water and energy resources remain pending; from time to time the branch Agreement on the Use of the Resources of the Syr Darya Basin is forgotten.

The *energy sphere* still lacks an adequate level of cooperation in the customs, tax, and tariff policies. The highly inefficient system of customs control over energy limits the effective functioning of the energy systems in the parallel regimes. The extremely varied national legislations in the sphere of taxation are of no benefit to energy exchange. As distinct from the other Central Asian countries, Kazakhstan taxes energy, this practice creating legal collisions and interfering with the energy systems' smooth functioning. There are no coordinated approaches to tariffs on energy transit, which suffers in the absence of a harmonized tariff methodology.

In the absence of a fairly developed oil and gas pipeline infrastructure, the Central Asian countries cannot develop their integration in the energy sphere. In Kazakhstan, for example, many of its large gas fields remain unconnected to export gas pipelines (Tengiz, Janajol, and Uritau, among others). Uzbekistan, the largest transit center of gas exports from Turkmenistan to Russia, which also sells its gas to Kazakhstan, Kyrgyzstan, Russia, and Turkmenistan, is limited in its gas export activities to a single gas pipeline that connects the region with Central Russia and the other CIS countries.

The *transport sphere* has not yet achieved rational functioning of the Central Asian countries' transit potential. In some cases, Kazakhstan's railway policy leaves much to be desired. This is especially true of the tariffs, which do not promote regional trade and economic contacts. This has already forced Uzbekistan to seek alternative routes for its products.

Agriculture is another sphere in which cooperation is limited, to say the least. In the mid-1990s, Uzbekistan tried the "grain self-sufficiency" policy and failed: its climate is much less suited to grain growing than that of Kazakhstan. In fact, the Central Asian countries should try coordinated approaches to the agrarian sector, regional division of labor, and agricultural specialization.

The different development rates and scales of economic liberalization, coupled with the low level of economic cooperation between the local states, do not allow them to make mutual trade more effective.

So far trade inside the region is limited to energy sources and the transit of commodities; export and import of industrial products and foodstuffs are negligible.

The recent positive trend (Table 1) has done nothing so far to raise mutual trade turnover to a higher level.

Table 1

Trade Turnover among the Central Asian States
(million dollars)

Countries	2000	2001	2002	2003	2004	2005	2006	January-May 2007
Kyrgyzstan	90.1	119.6	139.6	205.1	313.2	334.1	406.7	178.9
Tajikistan	57.8	63.5	48.8	82.7	139.6	167.6	185.1	111.8
Uzbekistan	212.5	229.0	188.5	218.7	429.3	497.1	703.8	525.3
Turkmenistan	50.5	91.7	89.8	86.3	101.6	68	153.3	64.8

Source: The Statistics Agency of the Republic of Kazakhstan.

Uzbekistan's EurAsEC membership expanded the cooperation potential of all of its members (the Central Asian countries included) and widened their trade and economic contacts: the integration structure is based on the Agreement on the Customs Union of 6 and 20 January, 1995; the Treaty on Deepening Integration in the Economic and Humanitarian Spheres of 29 March, 1996, and the Treaty on Customs Union and the Single Economic Expanse of 26 February, 1999, under which the signatories are exempt from customs dues on a bilateral basis.

Uzbekistan's membership obliges the country to harmonize its national legislation with the EurAsEC norms, which will allow it in the future to open its domestic market, create a favorable investment climate, and conduct adequate customs policies. Taken together, these measures will become an important factor of mutual trade. So far, inter-regional investment cooperation remains undevel-

oped. An analysis of data related to Kazakhstan investments in the Central Asian economies speaks of still untapped investment potential (see Table 2).

Table 2

**Kazakhstani Investments
in the Central Asian Economies in 2006
(million dollars)**

Kazakhstan	Kyrgyzstan	Uzbekistan	Tajikistan	Turkmenistan
	309.2	152.3	94.0	5.8

Source: National Bank of the Republic of Kazakhstan.

According to the National Bank of the Republic of Kazakhstan, in 2006 the country invested \$4,590.1 million in Russia; \$2,082.9 million in the U.K., and \$1,122.5 million in the Netherlands.

At the same time, Kazakhstan's efforts to promote mutually advantageous ties with its neighbors are expected to add vigor to cooperation in the investment sphere. What is needed is a mechanism of deeper integration cooperation among the region's states that will treat cooperation in the real sector of the economy and joint projects as a priority. One such priority can be found in the energy sector: the local countries need more energy capacities to achieve energy security and meet their needs for cheap energy. The Kambarata-1 and Kambarata-2 hydropower stations in Kyrgyzstan and the Sangtuda, Rogun, and smaller hydropower stations on the Zeravshan River in Tajikistan now being built by Russia, Kazakhstan, and other foreign investors are very important for regional energy security.

Modernization of the oil and gas sector and improvement of the oil and gas transportation infrastructure are overdue. The planned Caspian and Trans-Caspian gas pipelines and the Central Asia-China gas pipeline system can play an important role as well.

To improve cooperation in the transport sphere, develop local transit potential, manage water resources, and strengthen the local countries' food security, they should primarily create the mechanisms of

- (a) a water-and-energy consortium;
- (b) a transportation consortium, and
- (c) a foodstuffs consortium.

This, in turn, calls for the following conceptions:

Conception of Functioning of an International Water-and-Energy Consortium should identify the task of elaborating the joint balance for managing the region's water resources based on the calculated needs for water of each of the countries and the possibility of meeting these needs and coordinate approaches to deal with the threat of flooding in the border regions and to make joint efforts to reinforce the banks, improve water quality, and deal with ecological problems.

If realized, this balance will make it possible to identify the best possible mechanism for ensuring mutual supplies of fuel, energy, and water resources, which will be registered in the Conception.

Conception of Functioning of the International Transportation Consortium calls for efforts to develop railways and highways, as well as the local countries' transport potential and transport machine-building.

The following railway routes should be developed in particular:

- (a) China-Kazakhstan-Uzbekistan-Turkmenistan-Iran-Turkey-the Balkan countries;
- (b) The North-South corridor.

Development of transportation corridors presupposes, in turn, that the Central Asian countries should:

- coordinate their customs, tax, and tariff policies in the transportation sphere;
- act together to modernize the region's transportation infrastructure;
- pool forces to attract financial institutions to modernize the already functioning and construct new infrastructure facilities.

This Conception should also identify the priorities for developing transport machine- building, some of them being:

- (a) wider integration in aircraft building on the basis of the Tashkent Aircraft Plant and Kazakhstan's resources (the Turgai bauxite mines and energy from the Ekibastuz hydropower stations);
- (b) closer cooperation in the car industry; production of parts for UzDaewooavto; wider cooperation with the world leaders.

If realized, the Conception of Functioning of the International Transportation Consortium will help the Central Asian countries develop their transit potential, expand their trade and economic ties among themselves and with their key trade partners, such as Russia, China, the EU, the Middle Eastern and Asian Pacific countries, etc. They will have the opportunity to modernize their transportation infrastructures, develop related industries, create new jobs (especially in direct proximity to the transportation corridors) and, at some time in the future, set up a Single Transport Space.

Conception of Functioning of the International Foodstuffs Consortium should identify the main spheres of the local countries' coordinated agrarian policy to ensure their foodstuff security.

These measures call for specific practical steps designed to boost competitiveness of the agrarian sector:

- (a) the latest technologies in land tilling and cattle breeding should be applied on a wider scale, while the cropping capacity of all farm crops should be improved;
- (b) foreign investments should be attracted to the agricultural sector, which should learn to rely on foreign experience for the sake of faster development of all the Central Asian states' agro-industrial complexes;
- (c) the structure of the cultivated areas should be adjusted to real needs in specific types of foodstuffs; the same applies to the cultivars and crop varieties;
- (d) intergovernmental clusters should be set up to produce the locally needed foodstuffs: rice, grain, milk, meat, juices, and fruit and vegetable preserves.
- (e) an innovation infrastructure should be set up.

It should consist of technoparks set up for R&D purposes in agriculture.

International experience of the formation and development of innovation infrastructure has demonstrated that to be effective technoparks should be treated as special economic zones with taxation, tariff, and other privileges.

The above should go hand in hand with effective cooperation in the use of the region's mineral resources. This calls for processing raw materials into almost entirely finished end-products that could cover local needs and be sold to third countries.

This can be done through transnational financial-industrial groups and joint ventures, which means that the Central Asian states should intensify their cooperation in the following branches:

- (a) oil refinery;
- (b) ferrous and non-ferrous metallurgy;
- (c) mining and processing of uranium ores;
- (d) cotton processing and tailoring.

To become more efficient, joint ventures should be created in the oil refining sector that will use high oil refinery technologies.

The Ferghana and Bukhara oil refineries in Uzbekistan and the Atyrau, Pavlodar, and Shymkent oil refineries in Kazakhstan should be joined to form an interstate cluster as one of the elements of the local countries' harmonized policy in oil refinery and their move toward a common market of oil products.

Ferrous and non-ferrous metallurgy calls for wider cooperation to upgrade quality and competitiveness of iron ores, manganese, and chromite raw materials and achieve higher processing levels.

In view of the imminent modernization of the Central Asian oil and gas transportation system, local industry should concentrate on producing rolled bars, high-grade steel, and pipes.

In non-ferrous metallurgy, the Central Asian countries should pool efforts to learn to use high technologies for metallurgical treatment of polymetallic concentrates, integrated treatment of original ores, metal-containing scrap, radioactive scrap metal, and wastes and for increasing production volumes of rare, noble, and precious metals.

Joint ventures in gold mining look promising. (The largest gold mines found in the Kyzylkum desert in Uzbekistan yield 80-85 tons of gold every year. In the near future, Uzbekistan plans to mine no less than 140-150 tons, which means that gold mining will need larger investments.)

Mining and processing of uranium ores will profit from wider cooperation between Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan, which will improve management, modernize ore-dressing enterprises, and encourage joint research activities. Together they will find it easier to emerge onto the world markets.

The cotton-processing and tailoring industry will benefit from an interstate cotton cluster with a complete production cycle spanning all the stages: from cotton growing to the production of high-quality textiles.

Like all others, these branches will profit from foreign investments, part of which can be used to set up joint textile complexes.

To realize the above, to accelerate the development of the Central Asian processing sectors, and to improve their competitiveness, the Central Asian countries should draw and adopt corresponding intergovernmental decisions.

Deeper integration into real economy and the implementation of joint projects in industry and agriculture will be conducive to sustainable growth rates and greater stability and security in the region, and will also help the local states to integrate into the world community.

It has become abundantly clear that the currently obvious transnational threats can be averted only through more active regional cooperation and interaction with international institutions.