

INTEGRATION PROCESSES IN CENTRAL ASIA. PROSPECTS FOR A COMMON MARKET

Gulnur RAKHMATULLINA

*Ph.D. (Econ.), principal researcher,
Institute for Strategic Studies under the President of
the Republic of Kazakhstan
(Almaty, Kazakhstan)*

Globalization processes have a growing effect on the development of individual countries and the world economy, with the Central Asian states, among others, being drawn into their orbit. The advantages of globalization are realized precisely at the integration and regional levels. That is why it is so important today to implement the initiative launched by President Islam Karimov of Uzbekistan for creating a Central Asian Common Market (CACM). The idea is that this market should include Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. However, an analysis of the development of their cooperation shows that integration processes in the region have not yet reached the desired intensity and that many problems of interaction between these states in the real sector of the economy and in the social and cultural spheres have not been resolved.

A key problem of economic cooperation between the Central Asian (CA) states is rational use of their water and energy resources. With this aim in view, annual agreements are concluded on guaranteed supply of coal, fuel oil and gas from Kazakhstan and Uzbekistan to Kyrgyzstan, while the latter undertakes to supply the agriculture of these states with water during the vegetation period. But since Uzbekistan and Kazakhstan fail to perform their obligations in full, Kyrgyzstan's thermal power stations cannot reach the desired parameters, which puts additional pressure on the Naryn hydropower system, leading to an increase in water release from the Toktogul Reservoir and to a reduction in its volume. In other words, the mechanism for mutual supply of water and energy resources is virtually inoperative. If such practices continue, the level of the Toktogul Reservoir will drop to a critical point known as "dead storage."

In addition, there are still contradictions between Astana and Tashkent over Uzbekistan's intake of water from Syr Darya in the vegetation period beyond the agreed limit and the problem of pollution of this river. The supply of water to Kazakhstan's southern regions remains one of the most important problems for our republic, which could lead to tensions in interstate relations.

In order to improve the mechanism for rational use of water and energy resources, a project for the establishment of an International Water and Energy Consortium was put on the agenda back in the days of the Central Asian Economic Community (CAEC). Unfortunately, this project is still at the discussion stage.

Problems remain in the transport sector as well, connected with the rational use of the CA countries' transit potential. For example, the not too flexible railway policy sometimes pursued by Kazakhstan (mainly regarding tariff terms) is not conducive to an expansion of trade or economic ties between the countries of the region. In view of this, Uzbekistan's transport companies have been trying to find alternative routes for freight transportation and to a certain extent have resolved this problem. That is why Tashkent's interest in the creation of a Single Transport Space has waned significantly in recent years. The existence of numerous unresolved problems and the lack of concerted ac-

tion in addressing them hinders the development of integration processes in this area of the economy. In particular, the project for the creation of an International Transport Consortium, which could help the CA states to formulate a common policy in this area and effectively develop their transit potential, has not been implemented to date.

Lack of coordination is also evident in the sphere of agriculture. Thus, in the mid-1990s Tashkent pursued a policy designed to ensure "self-sufficiency in grain." But when it comes to grain crops, Uzbekistan's climatic conditions are much worse than those in Kazakhstan. That is why the measures taken by Tashkent in this area did not yield the desired results. It would make sense for the CA states to coordinate their approaches to the development of agriculture, including their policies on regional division of labor in this sector and specialization of agricultural production. Moreover, the Central Asian countries do not use the favorable opportunities for developing the processing sector of the food industry and do not take any measures to implement the project for the establishment of an International Food Consortium.

All these trends point to the existence of serious problems in the development of integration between the CA republics and, in particular, to lack of coordination in their economic policy, which is contrary to the treaties and agreements adopted within the framework of the Central Asian Cooperation Organization (CACO), primarily to the basic document on the creation of a Single Economic Space. So, the absence of a mechanism for implementing decisions taken at the interstate level is the main reason for the slowdown in regional integration processes.

Another factor holding back cooperation between the CA countries is the different pace of their economic development and market transformation.

The most stable rate of economic growth is recorded in Kazakhstan. Based on the results for the past few years and in the current period, Kazakhstan is among the leaders of the CIS countries in terms of GDP and industrial production growth. According to the republic's Statistics Agency, in 2004 its GDP grew by 9.4%, and industrial production, by 10.1%, and in the first quarter of 2005 the growth rates were 9.1% and 7.4%, respectively. In view of its stable pace of economic development and its efforts to create a favorable climate for foreign investment, Kazakhstan was the first CIS country to be assigned (in 2002) an investment grade rating by Moody's Investors Service; in May 2004, its foreign currency rating was upgraded from BB+ to BBB-, and its local currency rating, from BBB- to BBB.

In other Central Asian countries, economic growth is so far slower. In Kyrgyzstan, for example, growth rates in 2005 declined considerably. Whereas in 2004 its GDP grew by 7.1%, in the first quarter of 2005 it increased by only 2% (compared to the same period of the previous year), which is only a third of the figure for the first quarter of 2004 (when the increase was 6.1%). And in the first five months of 2005, GDP growth (compared to the same period of 2004) amounted to 3.3%. Industrial production in the first quarter of 2005 fell to 95.3% (108% in January-March 2004), and in the first five months of 2005, to 91.9%.

The situation in the Kyrgyzstan economy is due, in the first place, to the political events that have occurred in the republic (during the disturbances, according to experts, its economy was losing over \$1 million per day; thousands of small and medium businesses suffered huge losses from closed shops, merchandise markets and other trade and service facilities). Second, the republic has an ineffective economic structure hinging on two sectors: the electric power industry and gold mining. But there are serious problems in these sectors as well. In the electric power industry, equipment is 80% worn out; there are virtually no new generating facilities and no capital construction. In gold mining, there are big problems in the development of the Kumtor deposit. One should also note the poor development of the processing sector (primarily the food and light industry) and the tourist sector. Use of their potential with the attraction of large-scale investment could help to carry out structural changes in the country's economy and to the attainment of stable rates of growth.

In the mid-1990s, there were clear signs of regressive development in Uzbekistan as well, with a considerable worsening of the socioeconomic situation in the country. The relative economic upturn (in recent years, annual GDP growth ranged from 4% to 8%; in the first quarter of 2005, the GDP growth rate was 4.8%) has a purely extensive, resource-consuming nature.

The main factors holding back the country's economic development include slow market transformation, a high level of state regulation of the economy, which impedes the development of small and medium business, lack of favorable conditions for foreign investment, restrictive trade practices and corruption. According to the estimate of international financial organizations, macroeconomic indicators are grossly overstated (the official figures are at least twice as high as the actual figures), and declared economic growth is not accompanied by real qualitative development. In particular, living standards in the republic remain quite low, with pronounced income inequality. According to various estimates, from 40% to 80% of the country's citizens are living below the poverty line; real income per capita is 8-12 times lower than it was in the Soviet period, and the monthly wage of most employees is equivalent to \$5-\$15. Informal employment or labor activity concealed from supervisory bodies is a significant traditional source of additional household income. But whereas in the Soviet period it accounted for no more than 10-20% of total income, today its share is 25-50% or even higher. There is also growing social degradation, which manifests itself in the deprofessionalization of entire strata of the population. On the one hand, highly skilled personnel (engineers, researchers, teachers, etc.) are obliged to change their sphere of activity, joining the ranks of "shuttle" and other small traders; on the other hand, the quality of education and professional training tends to decline. The socioeconomic transformations carried out in the country have done virtually nothing to modernize the system of education, health care or the society in general. It is quite possible that the current state of affairs will persist in the medium term as well, and this is bound to lead to growing protest among a significant part of the population.¹

As regards Tajikistan, in terms of per capita GDP (\$236) it is the poorest country among the former Soviet republics and one of the poorest countries in the world. The UNDP Global Human Development Report for 2003 ranks the republic among the "top priority countries" in which poverty has led to a crisis requiring close attention and use of resources of the international community. The five-year civil war, which ended in 1997, emigration of skilled specialists and lack of a favorable investment climate—such are only some of the numerous factors hindering the country's economic development. And its geographical isolation compounds the problems in the field of regional cooperation: the mountains constituting over 90% of Tajikistan's territory are a big obstacle to transport and communications.

Fiscal and economic administration is complicated by the republic's large external debt, which did not exist before Tajikistan gained independence. Virtually the entire investment budget of the state is funded out of official development assistance. By agreement with the IMF, the country's government set a limit on new borrowing at 3% of GDP; in 2005, this limit was raised to 4% (with the possibility of further review).

A key problem of economic development is the high level of corruption and organized crime. The shadow economy, mostly connected with the transit of drugs through Tajikistan, is estimated at 100% of the country's GDP. The government regards organized crime in general and drug trafficking in particular as an interstate problem whose solution requires coordinated international efforts, seeking active cooperation with foreign partners. The situation that has taken shape in the region in view of illicit drug trafficking creates many problems for Tajikistan.²

¹ See: Kazakhstan i Uzbekistan: tochki konflikta [www.policy.kz].

² [www.undp.tj/documents/CPAP%20Rus.pdf].

In the late 1990s, the republic entered a period of economic stabilization. Over the past three years, the average annual rate of GDP growth was around 10%, but almost two-thirds of the population still live in poverty, so that a third of all adults (about 630 thousand) migrate to other countries every year in search of work. Less than 50% of rural inhabitants have access to tap water. Moreover, a significant part of the water supply system is unreliable and ineffective because of poor maintenance or, rather, lack of it. The incidence of infectious diseases and the rate of infant and maternal mortality in the republic are very high. The official average wage is \$10 per month.³

As we have already noted, the national economies of the Central Asian countries differ in terms of the pace of market transformation.

Kazakhstan, for example, is actively reforming its economy and taking measures to enhance its competitiveness. That is why the republic has become one of the first Commonwealth states to be recognized by the European Union and the United States as a market economy country.

In Uzbekistan, on the other hand, the creation of market mechanisms is at its initial stage. In particular, its economic development model is characterized by evolutionary transition to the market (without any “revolutionary leaps forward” or “shock therapy”) and continued tight control of the economy, which slows down the advance to sustainable economic growth. Strict control, a closed domestic market, and administrative and legal pressure on business prevent its efficient operation, considerably impeding the development of industrial production. Today most of the enterprises operating in the republic are unprofitable; some of them are on the brink of collapse and others operate at 15-20% of capacity (compared to 1991).⁴ The economy is increasingly inaccessible to international trade and investment. The measures being taken by the government to create favorable conditions for foreign investment are not translated into practice, primarily in view of the lack of transparency in political and economic decision-making, restrictive trade practices, high level of corruption, and other factors.

Pressure from international financial organizations induces the Tashkent authorities to carry out market reforms and liberalize foreign economic activity. But the government prefers half-measures: either these reforms are confined to the initial stage or parallel steps are taken to create conditions under which the economic transformations have no real significance. Such an approach is explained by the fact that today Uzbekistan lacks the resources required to finance the reforms and minimize the negative effects of the “shock therapy” period in the social sphere. There was a time when market reforms could be carried out at minimal social cost, but the republic’s authorities missed that opportunity. In current conditions, both economic transformations and a retention of the administrative-command model could entail a serious worsening of the socioeconomic situation.

The differences in the pace of market transformation and in the development models of the CA countries tend to limit mutual access for their industrial, commercial, financial and insurance capital to the markets of partner states, reduce the effectiveness of economic ties, and impede the advance to deeper integration forms and mechanisms. And the low level of their economic interaction becomes the main factor behind the ineffective development of mutual trade.

The increase in trade between the CA republics is also impeded by Uzbekistan’s special policy serving to restrict mutual trade: reduction in the range of goods involved in trade operations, exceptions to the free trade regime (for example, such exceptions in relations with Kazakhstan cover more than 100 items) and, as a result, the establishment of high rates of customs duties on imports and excise taxes, a ban on the export of certain goods, and restrictions on the registration of contracts between the economic entities of these states.

³ [www.undp.tj/documents/CPAP%20Rus.pdf].

⁴ See: Kazakhstan i Uzbekistan: tochki konflikta.

As a result, trade and economic relations between the CA countries are mostly confined to supply of energy resources and transit of goods. Mutual exports and imports of manufactures and food are very limited. For example, the CA countries account for only 2% of Kazakhstan's trade turnover, which is yet another indication of the untapped potential of mutual trade. It is true that in recent years a positive trend has been recorded in this area: in 2003, Kazakhstan's trade with Kyrgyzstan increased by 47%, and in 2004, by 48.4%; our republic's trade with Tajikistan increased by 69% and 66%, respectively, and with Uzbekistan, by 16% and 44%. However, the potential of the CA countries allows a higher level of mutual trade, because in many respects their economies are complementary, providing opportunities for widening the range of goods in their trade with each other. The current situation shows that there are many unresolved problems in this area.

Little progress has been made in regional investment cooperation as well. In Uzbekistan, for example, there are only about 50 enterprises with Kazakhstan capital (1.5%), which is primarily due to Tashkent's policy of limiting trade and economic ties with neighboring states. Similarly, the share of Kazakhstan enterprises is just as low in Kyrgyzstan (a considerable reduction in investment activity in this country is explained by the political events of the first half of 2005) and in Tajikistan, where Kazakhstan investments could be used, in our opinion, in the development of the energy sector, including the construction of the Sangtudin Hydroelectric Plant.

So, economic cooperation among the Central Asian states is clearly marking time. The level of implementation of the decisions being taken remains low, which means that these states are repeating the mistakes of the CIS, where many documents have been signed but few have been actually translated into practice.

On many issues a special position is adopted by Uzbekistan, whose active involvement is crucial to the effective development of integration processes in the region. In practice, the solution of problems relating to the development of cooperation ties unfortunately boils down to mutual apprehensions and mistrust instead of mutually beneficial cooperation.

That is why the implementation of the initiative to establish a Central Asian Common Market should be regarded primarily in the light of efforts to create a truly functioning free trade area, develop business and investment cooperation, pursue a concerted customs, tax and tariff policy, harmonize monetary and exchange relations, and take active measures to unify national legislation.

In order to implement the free trade regime, it would make sense to take measures to:

- carry out the decisions taken within the CACO framework on abolishing customs duties, taxes and charges, quantitative and other restrictions;
- harmonize the customs legislation of the common market countries, tariff and nontariff regulation mechanisms;
- ensure compliance with the principles of free transit.

Other major factors in the creation of a common market include harmonization of the macroeconomic policies of CA states and concerted action in carrying out economic reforms. In our view, concrete measures should be taken to even out the pace of market transformation in the economies of these countries and to create conditions for advancing toward a common market of goods and services. Priority here should be given to deepening cooperation in the financial and monetary spheres, ensuring free movement of capital and favorable conditions for the activities of business entities of the member countries, and setting up joint ventures and financial-industrial groups. Such measures will help to develop relations in the real sector of the economy and to create common markets of energy resources, transportation services and agricultural products. It is also important to develop mechanisms for the operation of sectoral consortia (water and energy, transport and food) and the respective conceptual

approaches. In particular, the Concept of an International Water and Energy Consortium should provide for the development of a joint balance for managing the region's water, fuel and energy resources, in which it is necessary to estimate the member states' demand for these resources and the opportunities for covering their shortages, formulate a common approach to dealing with the threats of border area flooding and to the performance of joint shore protection works, and project measures to improve water quality and address environmental problems.

In the Concept of an International Transport Consortium, it is necessary to project measures for developing rail and road transport routes, the transit potential of the member states and the appropriate branch of engineering. It is very important to concert the principles of customs, tax and tariff policy in the field of transport. In customs policy, for example, concrete measures should be taken to simplify customs clearance and control procedures at internal borders, to ensure unimpeded freight transportation between these countries and transit through their territories, and to implement the "two borders one stop" principle.

In the sphere of taxes, the member countries should develop a flexible taxation system for their transport companies in order to reduce tariffs on all kinds of transport. In the field of tariff policy, it is important to even out domestic and international railroad rates, since different rates hinder the development of interstate traffic and lead to a higher transport component in the final price of products. Over the long term, it will probably be necessary to develop a single tariff policy within the CACM framework, and also to take measures to unify and harmonize the member countries' transport legislation and to create appropriate legal conditions.

The implementation of the Transport Consortium Concept should help to develop the transit potential of the Central Asian Common Market countries, to extend their trade and economic ties within the CACM and their relations with their major trading partners outside the region (Russia, China, countries of the APR, EU, Middle East, etc.), to modernize their transportation infrastructure and develop related industries, to raise the level of employment (especially in areas along the transportation corridors) and to create a single transport space.

In the Concept of an International Food Consortium, it is necessary, in our view, to lay down guidelines for a concerted agroindustrial policy designed to ensure the member countries' food security. The implementation of these guidelines presupposes the development of concrete measures to enhance the competitiveness of the agricultural sector in the CA republics through the application of advanced technology in crop and livestock production, attraction of foreign investment, use of foreign experience, creation of interstate clusters for the production of foodstuffs (rice, grain, meat and dairy products, juices, canned fruits and vegetables) and development of an innovative infrastructure. Overall, a solution of these problems should help to enhance the competitiveness of agriculture in the CA countries, to fill their consumer market with high-quality products and, in the long run, to create a common agricultural market.

So, the development of economic cooperation between the Central Asian countries with the establishment of an effectively functioning free trade area is an important stage on the road to a common market, which will help to ensure sustainable development of the member countries and their successful integration into the world community, bring them closer to a single economic space, raise living standards, and ensure stability and security in Central Asia.