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# CENTRAL ASIA BETWEEN WEST AND EAST

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**W**hen I was first asked to speak about the prospects of EU expansion into Central Asia, I replied that this would be a very short paper! There is no such prospect. But no one with my love for speaking would let it go at that. So I decided to interpret the question in a differ-

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ent way: would it be preferable for some or all of the Central Asian countries to seek some kind of associate status with the West or with the East, or with neither, or with both—through the World Trade Organization? And would they be accepted by the EU, ASEAN, or the WTO? Would closer ties with Russia or China be a good idea? In this essay these possibilities are considered in turn.

Let's start with a few definitions and basic facts. I define the Central Asian (CA) states as the former Soviet republics of Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. The first is to the west of the Caspian Sea, but its culture and political-economic regime are similar to the others. The Xinjiang-Uighur Autonomous Region of the People's Republic of China, Afghanistan, the Azeri parts of Iran, and several Turkic<sup>1</sup> parts of the Russian Federation might likewise be included as Central Asian, but except for Afghanistan, none of these areas is a sovereign entity able to arrange its own trade affairs. Since the Treaty on European Union specifies that membership is open to "European" states, the implication is that these clearly Asian states are not even remotely candidates for membership in the EU.<sup>2</sup>

All these six Turkestani states of Central Asia are landlocked, remote from the main world markets. Azerbaijan has just been connected to the Mediterranean by the Baku-Tbilisi-Ceyhan oil pipeline, and Turkmenistan and Kazakhstan have gas or oil connections to Russia, but these are limited in capacity. All six states are ruled by authoritarian presidents who hold to an ideology of secular nationalism as opposed to political Islam. None is a "democratic" state. Human rights, free media, and an independent judiciary are all missing. Not one has held a fair election, in the estimation of OSCE or other outsider observers. All suffer from corruption and weak protection of

private property, especially the petroleum-rich states among them. Hence, even aside from geography, they do not presently meet the Copenhagen criteria for membership in the European Union.

Within a basically authoritarian political regime, all of these regimes have pursued some gradual economic reforms, with an external strategy I call "export globalism"—dependence on staple exports with multilateralism as contrasted with regional integration or neocolonialism. Except for the capital or main commercial cities, they are poor, even if high energy prices lately appears to put Kazakhstan, Azerbaijan, and possibly Turkmenistan into a slightly higher GNI category. Owing to Soviet-era development of their health and educational facilities, their U.N. (UNDP) human development indices are rated "medium." The poorest sections of Uzbekistan (Karakalpakstan, near the devastated Aral Sea), parts of Kazakhstan, and the mountainous regions of Tajikistan and Kyrgyzstan have lost significant population, as many males have left for Russia or elsewhere to earn money in manual labor. Skilled Germans, Slavs, and Jews had departed in the 1990s.

The major differences among them materialize from their different endowments of energy: besides the three oil and gas exporters, Uzbekistan is basically self-sufficient in energy (and food), while the poorest and smallest two, Kyrgyzstan and Tajikistan, need to import fuel, while trying to develop their abundant potential for hydropower to sell to surrounding countries. As a result of their petroleum and gas exports and their effect on incomes and exchange rates, Kazakhstan, Azerbaijan, and Turkmenistan have lost industry and agriculture, while Uzbekistan has maintained its former sectoral structure (see Table).

Aside from petroleum investments around the Caspian littoral and some nonferrous mineral operations, there has been relatively little foreign direct investment anywhere in the region. This may change somewhat with Russian and Chinese exploration and pipeline projects long discussed. Foreign aid and assistance from such international financial agencies as the World

<sup>1</sup> Tajikistan and Afghanistan are ethnically Central Asian, but linguistically West Iranian.

<sup>2</sup> One might perhaps argue that Turkey, Georgia, and Armenia are culturally "European," because of language, religion, or geography,—hence possible future candidates—but in Central Asia only the northern tier of Kazakhstan has any significant European population.

Table

## Basic Economic Data

Country	GNI/ capita, 2003, ppp* (\$)	Growth index, 1990-2003	Growth, 2003/02 (%)	agric+ mfg, 2003 (%)	Gini Coeff.	%top 10%
Azerbaijan	3,390	82	11.2	37	.365	29.5
Kazakhstan	6,280	92	9.2	24	.323	24.4
Kyrgyzstan	1,690	83	6.7	47	.348	27.9
Tajikistan	1,040	49	10.2	43**	.326	25.6
Turkmenistan	1,120	112	16.9	69**	.408	31.7
Uzbekistan	1,720	117	4.4	44	.268	22.0

\* ppp (purchasing power parity)—i.e., adjusted for comparable national prices.  
 \*\* Agriculture plus "industry," including manufacturing, mining, construction, and utilities.

*Comments on data:* GNI per capita estimates variable and incomparable across editions of the data source. Turkmenistan's official data are particularly unreliable.

*Source:* 2005 World Development Indicators (World Bank, 2005).

Bank, EBRD, and the Asian Development Bank are fairly modest.<sup>3</sup>

<sup>3</sup> For a somewhat more detailed survey of these countries, the reader may consult my "Central Asia on the Edge of Globalization," *Challenge*, Spring 2004 or the longer essays on Uzbekistan, Turkmenistan, Tajikistan, Kyrgyzstan, and Kazakhstan in *The Economic Prospects of the CIS, Sources of Long Term Growth*, ed. by Gur Ofer and Richard Pomfret, Edward Elgar Publishers, Cheltenham, U.K. and Northampton, MA, 2004. Richard Pomfret's forthcoming book from Princeton University Press is the most

While all these secular Muslim countries are friendly to the West, as well as to Russia and China, only Uzbekistan and Kyrgyzstan have American bases, set up to aid the war on the Taliban in Afghanistan. Regional economic and security arrangements, as we shall see, have failed to come to any tangible result.

authoritative recent treatment of Central Asian economies as a whole.

## The Present Situation

All six of the Central Asian states have fairly open economies<sup>4</sup> and have tried, albeit inconsistently, to retain the unimpeded trade which characterized their former membership in the Soviet Un-

<sup>4</sup> In 2000 export/GDP ratios were 59% for Kazakhstan, 42% for Kyrgyzstan, 81% for Tajikistan, 63% for Turkmenistan, and 25% for Uzbekistan; but the last figure will be higher for 2004-2005 because of the return to a convertible soum (see: The World Bank, 2004, p. 9). The area's staple exports often pass through entrepôt markets, such as Switzerland or Bermuda.

ion. In principle, indeed, much of trade with former Soviet republics is still tariff-free. At the same time, however, they all have tried and mostly succeeded by 1996 to diversify their trade partners beyond the former Soviet Union.<sup>5</sup> As one consequence of their desire for independence, neither the Commonwealth of Independent States (composed of twelve of the fifteen Soviet titular national republics) nor repeated attempts to institute regional preferential trading blocs have succeeded, owing to conflicting priorities and chronic interference by member states.<sup>6</sup> Kazakhstan and its small neighbor Kyrgyzstan have preferred closer association with the Russian Federation; Azerbaijan and especially Uzbekistan have tried to keep their distance from the former imperial master, while Turkmenistan professes neutrality. Isolated, very poor, and conflict-riven Tajikistan has tried to get the attention of several bigger partners with little result so far, except for drug smugglers originating in Afghanistan.

In practice, the main Central Asian countries have repeatedly impeded free access to their markets, despite relatively modest *de jure* tariff rates.<sup>7</sup> Besides recurrent blockades and chronic bribes extracted at the borders—perhaps as a substitute for official tariffs, but still unpredictable—several countries charge excise and other taxes on imported goods different from those on similar domestic articles. Like limits on foreign exchange, these imposts also function as protection from imports.

Considering that present exports from Central Asia are staples and energy not subject to tariffs, the major advantages to be gained from trade treaties would be potential development of manufactures and privileges to bring in agricultural products such as fresh fruit, flowers, and nuts from the bountiful Ferghana Valley, provided quality can be maintained to market destinations.

## A European Connection?

It seems obvious that any formal association between the European Union and the Turkic states of Central Asia will depend, first of all, on decisions with respect to Turkey's membership, and then to the disposition of Ukraine and Russia, which adjoin Central Asia. Turkey and Ukraine are officially ambitious to join. But Russia? Others will presumably speak about Russia's prospects. It is not unthinkable. Victor Hugo's appeal for European unity more than 150 years ago was addressed to arch-conservative Russia, as well as monarchical Germany and republican France. Italian prime minister Silvio Berlusconi has suggested that Russia might eventually join the EU; in his estimation, Russia's 27 billionaires will presumably not disqualify that country! Grigory Yavlinskiy, head of the Yabloko liberal bloc (now rapidly peeling off, for lack of core values, I suppose) has also talked of this, but not Vladimir Putin. For this avatar of great power status, the prospect of dreary Brussels haggling with puny fellow members, talk of "shared sovereignty," even the dismantling of borders can hardly be appealing. Putin has recently been less than cordial about any territorial deals with tiny Latvia or even a lucrative compromise with Japan over the Kuriles. Better to take on the EU as a whole, and be careful about its expansionist potential, promoted by Poland or other new, former satellite members.

Russia cannot be discounted, however, even if it is no longer considered a military threat. Germany gets about half of its natural gas from Russia, Turkey more and more, and Russia's gas monop-

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<sup>5</sup> Russia's share in the Central Asian markets temporarily expanded following its 1998 devaluation. Despite poor rail and road connections, the Russian Federation remains a natural market for Central Asian goods, as judged by distances, as well as familiarity with market conditions.

<sup>6</sup> See: M.C. Spechler, "Regional Cooperation in Central Asia," *Problems of Post-Communism*, Journal of Central Asian Studies, Vol. IV, No. 1, November-December, 2002, pp. 42-47. Little has changed since 2002 in this regard.

<sup>7</sup> Uzbekistan has the highest general tariff rate—an average of 19%.

list Gasprom is counting on Central Asia for new reserves of that essential fuel.<sup>8</sup> European demands for natural gas are expected to double by 2030. Were the EU to turn into a looser organization and lose the big power ambitions promoted by the French, a more formal and reliable connection with the eastern neighbors would be logical and productive, particularly if Chinese and Asian competitors for energy continue to press their claims.

Were Russia taken in, that would presumably qualify Central Asia for the same kind of aid and trade patronage now extended to 77 former colonies of Great Britain, France, and Portugal. Whenever a significant new member has been added to the EU, it brings with it historical and cultural commitments and sympathies to non-European communities. The accession of Spain and Portugal increased EU interest in Latin America; Finland and Sweden, to their northern neighbors.<sup>9</sup> Most to the point, Poland has energetically raised the future prospects of Moldova, Ukraine, and even a democratized Belarus for membership.<sup>10</sup>

Future Turkish accession presents a more immediate opening for Central Asian and Caucasian states. As part of the negotiations during the next decade or so, Turkey will very likely be pressured to make up with Armenia (which brings in fellow Christian Georgia), just as they have had to do with semi-occupied Cyprus. As for Central Asia, Turkey regards it as its cultural sphere of influence. While “association or Europe agreements” would seem out of the question for Turkic Central Asia—because they hold out some kind of long-term free trade area or even accession—a version of the Lomé or Mediterranean agreements does not seem impossible with Kazakhstan and Kyrgyzstan at least, possibly a democratized Uzbekistan.

Indeed, the EU has already negotiated economic cooperation agreements with Russia and Ukraine (1994), as well as Kazakhstan in 1995. These regional initiatives are targeted on noncandidate partners with a clear interest in reform—the so-called European Neighborhood Policy. That offers graduated access to the single European market, together with financial and technical assistance.<sup>11</sup> It was accompanied by talk of a “Common Economic Space” to include Russia, but the concrete meaning of this slogan is still unclear. In light of recent popular opposition to immigrant labor within several EU countries, such agreements cannot include legalizing workers from further east, where incomes are a small fraction of those in Europe and cultural norms quite different, too. For the EU, the wide-ranging preferential commodity *trade* agreements are a kind of soft alliance helpful in multilateral forums, like the WTO.

As of mid-2003, free trade agreements had been negotiated by the EU with eight Mediterranean states, plus the Palestinian Authority, so obviously democracy and “European” Christianity are no prerequisite for these preferences. Mexico and Chile also have such agreements, so distance need not be a bar, either. Accession of new members has also brought previously neglected sectors to the agenda for liberalization: Greece on shipping, Finland on telecommunication services. On the other hand, while accession sometimes opens the door to relatives, it can complicate their reception, too. Spain and Greece are cotton growing regions and have opposed reduction of the EU’s approximately \$1 billion in CAP support for this crop, a staple in Central Asia, as well as franco-phone Africa.<sup>12</sup> This is just one example of how the more recently admitted members of the EU

<sup>8</sup> Besides its North Caucasus fields, Russia gets natural gas from Turkmenistan, Kazakhstan, Uzbekistan, and Azerbaijan in that order.

<sup>9</sup> See: *European Union Enlargement*, ed. by N. Nugent, Palgrave Macmillan, New York, 2004, p. 214.

<sup>10</sup> See: W. Cimoszewicz, “The Eastern Dimension of the European Union. The Polish View,” Speech at the conference “The EU Enlargement and Neighborhood Policy” [www.msz.gov.pl/start.php]. At the time, Mr. Cimoszewicz was Poland’s Minister of Foreign Affairs.

<sup>11</sup> See: *The Economist*, 25 June, 2005, p. 4. Russia would probably settle for visa-free entry and institutionalized political consultations, as it has with NATO.

<sup>12</sup> See: *European Union Enlargement*, p. 134. Permit me as an American to admit the contradiction between my government’s free trade and development rhetoric and its outrageous \$3 billion support for cotton farmers in the U.S.

might oppose any further expansion eastward, owing to potential competition with their large agricultural sectors, likely diversion of structural funds, and the southern members' weaker technological edge in those eastern markets.<sup>13</sup>

The EU has also signed Partnership and Cooperation Agreements with Kazakhstan, the Kyrgyz Republic, and Uzbekistan, as well as Trade and Cooperation Agreements with Tajikistan and Turkmenistan. The EU's regional policy is contained in the Commission's "Strategy Paper 2002-6 and Indicative Program 2002-4 for Central Asia," published in October 2002, setting out technical assistance to the five CA countries in the amount of €150 million for 2002-4, as well as 2005-6. That's some €3-4 per person, less than half the amount budgeted for the European members of the CIS, and far less than for the Mediterranean and Balkan neighbors. The objectives for Central Asia are security, stability, sustainable development, poverty reduction, and regional cooperation in energy, transport, and environmental issues. Border control, institutional building, small and medium-sized enterprises are other objectives.

While EU preferential access and development aid (the bilateral technical assistance program, TACIS, for example) are thus practical realities which might be expanded, particularly if democratic reforms progress in Central Asia, these do not conflict with the remaining options for the CA states. Of the more than 170 regional agreements around the world, including the dormant ones within the CIS, the one which seems most promising for Central Asia would be ASEAN.

## ASEAN—An International Group of Semi-Developed Countries

The Association of South East Asian Nations, created in 1967 as a bulwark against Communism, has expanded now to ten nations<sup>14</sup>—including Communist Vietnam in 1995—and will soon establish special relations with China. ASEAN's free trade area (AFTA), initiated in 1992, marked a modest acceleration of its economic accomplishments.<sup>15</sup> This arrangement includes a common effective preferential tariff, essentially a timetable for significant reciprocal reductions in industrial and agricultural rates, and a dispute settlement mechanism—one of the first *supranational* elements in this formerly *intergovernmental* alliance.<sup>16</sup>

With the accession of Vietnam and opening to China, it is obvious that ASEAN is not limited to democratic, market-based countries, as is the EU. Nor do the boundaries of "Southeast Asia" necessarily exclude Tajikistan, Kyrgyzstan, or Uzbekistan. True, historical precedent does reinforce the idea of ASEAN+4 regional integration, which excludes former Soviet republics as more "European," but this could change.<sup>17</sup> Furthermore, ASEAN's consensual style of decision-making, re-

<sup>13</sup> See: A. Adam, Th. Moutos, "The Political Economy of EU Enlargement: Or, Why Japan is Not a Candidate Country," in: *Managing European Union Enlargement*, ed. by H. Berger and Th. Moutos, MIT Press, Cambridge, 2004, p. 290.

<sup>14</sup> From rich to poor, Singapore, Malaysia, Thailand, the Philippines, Indonesia—the original members—then Brunei, Vietnam, Myanmar (Burma), Cambodia, and the Lao PDR. The last four joined in the late 1990s. Their total population exceeds 540 million with an average income of about \$3,500 per capita at purchasing power parity—a level of GDP per head not very different from Central Asia.

<sup>15</sup> See: Sh. Narine, *Explaining ASEAN. Regionalism in Southeast Asia*, Lynne Rienner, Boulder, CO, 2002, pp. 131ff.

<sup>16</sup> New members must also eliminate nontariff barriers, harmonize their customs nomenclatures, and implement the GATT Valuation Agreement. All these measures would be helpful to Central Asian trade.

<sup>17</sup> ASEAN countries are in fact quite diverse culturally: Buddhist, Islamic, and Sinic. English is usually the language of intra-regional meetings. Internationally and within the Central Asian region, too, CA is usually assigned to Europe or Eurasia, though Tashkent shares a longitude with Bombay.

flecting enduring concern for independent sovereignty,<sup>18</sup> would match the Central Asians' desires to preserve their new-found independence. The medium size of most of ASEAN's members (Indonesia and oil-rich Brunei excepted) would make a better fit with the Central Asian countries than the European Union. Most of the ASEAN-10 have grown rapidly during the last dozen years, and their formerly modest intra-regional trade in manufactures has increased somewhat owing to diverse specializations.<sup>19</sup>

Central Asian countries might well benefit materially from association with ASEAN. If Central Asia could break into the highly protected agricultural market in nearby Southeast Asia (as of the late 1990s, tariffs from 23 to 57%, except for Singapore), Central Asia could expand its export of fruits, vegetables, and feed grains. These goods are already available cheaply in the Ferghana Valley. With regard to future, dynamic areas of comparative advantage, regional blocs of developing countries increase attractiveness to FDI because of economies of scale, scope, and agglomeration.<sup>20</sup> Specifically, it seems likely that growing imports from the more developed ASEAN countries provide an indirect technological spillover, just as the latter gained from imports from the U.S., Europe, and Japan.<sup>21</sup> With the level of technically trained manpower still available in Central Asia—particularly in Uzbekistan—foreign direct investment and imports of advanced products would be advantageous to growth prospects. Were the Central Asian states to be allowed to enter the ASEAN investment area, they might also benefit from multinationals' vertically integrated investments, owing to the lower wages paid. Several ASEAN firms have recently acquired subsidiary companies elsewhere in the region—for example, Singapore Telecommunications LTD bought firms in Indonesia and Thailand.<sup>22</sup> An example of agglomeration economies which can spread to neighboring countries is the rapidly growing garment industry in Cambodia and Lao PDR during the last 15 years, which is owing to investments from other Asian economies constrained by rising wages as well as quotas on their direct exports placed by the Multifiber Arrangement. Most favored nation treatment and GSP preferences have helped ASEAN's exports to the EU and North America in most cases.<sup>23</sup> All this would increase trade creation. Trade creation would also occur if Uzbekistan were to reduce its protection of its household electronics, automotive, and refined petroleum industries, in which its neighbors would be competitive.

With the typically low official tariffs in Central Asia, the possibility of trade diversion would be minimal with accession to ASEAN, APEC, or indeed any other liberalizing group. Therefore, the long-run benefits from export expansion and imports of cheaper materials are unlikely to be offset by the distortion of trade in favor of inefficient member states.

<sup>18</sup> See: D. Webber, "Two Funerals and a Wedding? The Ups and Downs of Regionalism in East Asia and Asia Pacific after the Asian Crisis," in: *Comparative Regional Integration*, ed. by F. Laursen, Ashgate, Aldershot, Hampshire, England, 2003, p. 138.

<sup>19</sup> Intra-regional trade was 22% of ASEAN total trade as of 1999, as compared with 63% in the EU at that time (see: *Ibidem*).

<sup>20</sup> See: S. Andriamananjara, M. Schiff, "Regional Cooperation Among Microstates," *Review of International Economics*, Vol. 9, No. 1, 2001, pp. 41-51; P. Athukorala, J. Menon, "AFTA and the Investment-Trade Nexus in ASEAN," *World Economy*, Blackwell Publishing, Oxford UK, Vol. 20, No. 2, 1997, pp. 15-174. Japanese FDI is a strong force for regional integration in Southeast Asia, especially monetary integration these days.

<sup>21</sup> See: O. Lumenga-Neso, M. Olarreaga, M. Schiff, "On 'Indirect' Trade-Related R&D Spillovers," *Policy Research Working Paper 2580*, The World Bank, Washington, D.C., 2001.

<sup>22</sup> See: "China Isn't Only Game in Asia," *Wall Street Journal*, 12 May, 2005, p. A13.

<sup>23</sup> The EU does not grant GSP status to Myanmar because of its human rights record, but as a member of WTO, that country must be granted MFN. This experience might well be relevant in the case of Uzbekistan, Turkmenistan, or even Kazakhstan. On the other hand, the EU does grant special GSP "regional cumulative rules of origin" provisions for processing operations carried out within ASEAN. Reportedly this helped Lao PDR garments to enter the EU (see: E. Fukase, W. Martin, "Economic Impacts of ASEAN Free Trade Area Accession for the Lao People's Democratic Republic," in: *ASEAN Enlargement: Impacts and Implications*, ed. by M. Than and C. Gates, Institute of Southeast Asian Studies, Singapore, 2000).

Like other regional blocs, ASEAN holds out to smaller, weaker potential members increased bargaining power.<sup>24</sup> AFTA can be a “training ground” for broader liberalization, rather than an ultimate goal. New members, such as Tajikistan and Kyrgyzstan, lack the experienced human and physical resources to carry on multilateral or several bilateral negotiations by themselves. A grouping like ASEAN can be helpful here, as they pool efforts in Geneva. It’s important to note that ASEAN membership by no means excludes accession to the World Trade Organization, as several of the new members have started negotiations to that end. ASEAN membership would doubtless also improve inter-governmental security cooperation regarding the threat of radical Islamic movements, such as Jemaah Islamiyah.<sup>25</sup>

Since the Central Asian countries have entered into regional trade deals with each other—and then violated their terms and spirit—a crucial question is whether ASEAN would provide better discipline than the several CA-only bodies or perhaps the WTO.<sup>26</sup> Neighboring countries like Singapore or Thailand have the ability and interest in monitoring policy in their ASEAN partners, and the reciprocal nature of tariff concessions gives them a means to enforce their will. But they are somewhat removed from the internecine quarrels which have troubled Central Asian relations—for example, over border questions or nonpayment of utility bills. Optimistically, ASEAN models might even encourage better macroeconomic, policy and infrastructural decisions in Central Asia, but according to two close observers, “it is not clear that ASEAN membership provides sufficient discipline and credibility to materially improve general economic policies.”<sup>27</sup>

An instructive example for Central Asia would be Vietnam. Following the decision in 1986 to reform its Communist economy (*doi moi*), Vietnam has experienced fast growth—7.5% from 1990 through 2003, according to the World Bank. Nevertheless, as of 1997 it still had an average MFN tariff rate of 19%—much higher for processed food—with its exports heavily directed to non-ASEAN members (except for Singapore). More generally, in the judgment of two specialists, it “remains one of the most distorted economies in the region. The state sector still enjoys various privileges, including access to land, capital, and quota allocation. An import substitution policy has been used to promote a set of capital-intensive and ‘strategic’ industries, which are often run by joint ventures between SOEs (state-owned enterprises) and foreign firms, and high protection is used to attract foreign investments. Preferential treatment of these industries imposes an implicit tax on small and medium-sized firms in the private sector, which are usually labor-intensive.”<sup>28</sup>

The similarities to their own situation would hardly need to be pointed out to Uzbek economists. From a common starting point Vietnam might show the Central Asians the way to improve resource allocation by favoring industries with comparative advantage in the global marketplace. In its negotiation with the WTO, Vietnam has offered to reduce its tariffs, quotas, and other nontariff barriers to trade; accession by the end of 2005 is expected.<sup>29</sup> Its Communist Party has also committed itself to broad internal reforms, but as in Central Asia, implementation is the key. A simple simulation by Fukase

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<sup>24</sup> Former Prime Minister of Singapore Lee Kuan Yew mentioned this in the *Straits Times*, 23 January, 2001 (Quoted from: D. Webber, op. cit., p. 145).

<sup>25</sup> See: B. Desker, “Islam in Southeast Asia: The Challenge of Radical Interpretations,” *Cambridge Review of International Affairs*, Vol. 16, No. 3, October 2003, pp. 415-28.

<sup>26</sup> Assuming the presidents in Central Asia wish to liberalize, WTO membership might give them “cover” (see: Eskender Trushin, Eshref Trushin, “Kazakhstan and Uzbekistan: The Economic Consequences of Membership in the World Trade Organization,” in: *Central Asia and the New Global Economy*, ed. by Boris Rumer, M.E. Sharpe, Armonk, New York, 2000, p. 197). The authors are experienced Uzbekistan nationals.

<sup>27</sup> E. Fukase, L.A. Winters, “Possible Dynamic Effects of AFTA for the New Member Countries,” *The World Economy*, 2003, pp. 853-871.

<sup>28</sup> E. Fukase, W. Martin, *Free Trade Area Membership as a Stepping Stone to Development. The Case of ASEAN*. World Bank Discussion Paper No. 421, The World Bank, Washington, D.C., 2001, p. 112.

<sup>29</sup> See: Vo Tri Thanh, “Vietnam’s Trade Liberalization and International Economic Integration: Evolution, Problems, and Challenges,” *ASEAN Economic Bulletin*, Vol. 22, No. 1, 2005, pp. 75-91.



and Martin indicated that a nondiscriminatory liberalization by Vietnam would increase its agricultural sales and also expand its manufacturing sector, owing to the import of cheaper materials. However, a newer study by D. Ronald-Hoist and others found that capital insufficiency and low skill employment would not be significantly eased until its capital markets are reformed to allow more FDI flows.<sup>30</sup>

Several studies have shown that trade liberalization in ASEAN would be beneficial, particularly to Singapore and perhaps Malaysia, but liberalization on a MFN basis would result in “substantially larger gains in trade and economic welfare.”<sup>31</sup> Both Indonesia and the Philippines have accepted this proposition and promise to extend their ASEAN concessions to others on a nondiscriminatory basis. The examples of the Lao PDR, Vietnam, and Cambodia demonstrate that trade expansion for Central Asian exports (for example, chemical fertilizers) might be a significant gain, while trade diversion is unlikely from reciprocal reductions of tariffs, given their low nominal rates at present in CA. Increased competition from ASEAN neighbors might also, at least in time, increase the efficiency of CA manufacturing and processing industries.

While ASEAN would, in my opinion, provide some benefits to Central Asia without imposing itself too much on the treasured political independence of those states, I have to report finding no interest at all in ASEAN literature for expanding into the interior of Asia. Whether concerns of Japan and Vietnam to contain China will suggest that course is mere speculation at this point. So that leaves the Central Asian states one open invitation only: the World Trade Organization.

## The World Trade Organization— Benefits of Multilateralism

The WTO functions to regularize trade policies, especially most-favored nation (nondiscriminatory) treatment, and to resolve trade disputes. Standardization of commercial rules for international trade reduces transaction costs and increases welfare for all participants. Aside from everything else, WTO membership would benefit the Central Asian countries, assuming they could and would comply with the regulations agreed to. Like EU candidacy, WTO membership appears to be associated with (cause?) domestic reforms, which have been pursued slowly in Central Asia.

Only one of the Central Asian states now belongs to the WTO: Kyrgyzstan, which acceded in 1998. Kazakhstan applied for membership in 1996 and has participated in several working party meetings recently, as has neighboring Russia. Both Kazakhstan and Russia are now treated as “market economies,” so that on their expected accession they will be somewhat protected from anti-dumping actions by the U.S. and others. Kazakhstan has deregulated its foreign trade—another requirement. Were Russia to benefit from WTO membership, demand for Kazakhstan’s exports would certainly improve, provided that country can compete on quality with other suppliers. Foreign direct investment might be expected in Kazakhstan’s metal-fabricating branch, as well as others.

Tajikistan and Uzbekistan have also applied, but their applications appear to be stalled, with no formal offers yet extended. Uzbekistan still engages in substantial state-trading and sets prices for its cotton, metals, and energy exports. Subsidies and off-budget credit have been reduced, but some transactions are not transparent. These are major economic obstacles to successful negotiations. Politics also counts. Following the Andijon massacre in May 2005, Uzbekistan may wait for a long time, as China did after the similar Tiananmen Square incident of 1989. Considering that more than 140 of the

<sup>30</sup> See: Vo Tri Thanh, op. cit. This multi-sector study was circulated as a discussion paper by CIEM-NIAS (Hanoi) in 2002.

<sup>31</sup> E. Fukase, W. Martin, *Free Trade Area Membership...*, citing computable general equilibrium studies by D.A. De-Rosa for the International Food Policy Research Institute in 1995 and J.D. Lewis and Sherman Robinson for the World Bank in 1996.

world's states do belong to the WTO, Central Asia may lose because of several states' exclusion from this body. WTO markets for Central Asia's textiles, leather goods, and chemical products would be attractive. As for trade with the wider world, Uzbekistan and Tajikistan have an interest in pressing the U.S. and EU to reduce their large and inefficient cotton subsidies<sup>32</sup>; WTO membership would facilitate joining Brazil and West African growers in that effort.

Regional preferences conflict with MFN, and any regional trade agreement (RTA) such as those launched in Central Asia would have to be approved by the WTO (under Article XXIV of the GATT), but the WTO has looked indulgently on such arrangements in the developing world. To quote Mike Moore, former WTO director-general: "Regional trade agreements, working in parallel with general liberalization, can help countries—particularly developing countries—build on their comparative advantages, sharpen the efficiency of their industries and act as a springboard to integration into the world economy. In addition, they help focus and strengthen the political commitment to open economies and trade regimes, which is essential to maintain. They have also served as an important context for trade policy innovation (e.g., the EU on competition policy and APEC's work on information technology and trade facilitation). And regionalism can sometimes accelerate the pace of other regional and multilateral initiatives...The contribution RTAs have made in their own right to promoting dialog, cooperation, and peace should not be underestimated."<sup>33</sup>

That said, the WTO has warned against trade diversion and import-substitution schemes for small developing countries. Moreover, multiple memberships strain a country's negotiating capacity and can complicate business rules of origin, as well as health, and safety requirements. But the fact that many smaller nations want to join nearby RTAs anyway reflects an abiding weakness of the multilateral trading system.<sup>34</sup> While tariffs have come down, nontariff barriers (voluntary export restraints, orderly market agreements, dumping investigations, bureaucratic influence, etc.) have come to replace them on a massive scale.

## A Chinese Co-Prosperity Sphere?

China joined the WTO in 2001 and has reportedly lived up to its commitments, except for the protection of intellectual property. In view of the PRC's strong growth and need of energy (and increasingly, skilled labor), WTO privileges would help open the Chinese market to Central Asian manufactures and perhaps food products. Trade with Xinjiang-Uighur Autonomous Region (XUAR) has always been small for both partners, but new transportation links and political rapprochement could improve both official and unrecorded trade. China's concern about Uighur separatism has made them eager to propitiate the governments in Central Asia willing to control Uighur liberation groups resident in those neighboring countries.

With spectacular growth over the last three decades (9.4% last year), an undervalued yuan, and mounting reserves (\$659 billion as of March 2005), China has the means and, evidently, also the desire to extend its influence throughout Asia. Trade between China and Southeast Asia is growing at an astounding 20% a year. China has signed bilateral cooperation agreements with the Philippines, Singapore, and Indonesia. Beijing and ASEAN have already agreed to a free-trade pact to take effect in 2010. Myanmar has received more than \$1 billion in military hardware, and Tajikistan, Kyrgyzstan,

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<sup>32</sup> Richard Pomfret has estimated that Uzbekistan could benefit to the amount of 3 to 5% of its GDP if US/EU cotton subsidies were removed.

<sup>33</sup> United Nations Conference on Trade and Development, *Regional Integration and the World Economy*, 16 October, 2000, United Nations, New York and Geneva, 2001, pp. 13-14.

<sup>34</sup> See: *Regional Integration and the Multilateral Trading System*, OECD, 1995, p. 81. This unofficial report found that existing regional and multilateral approaches have been complementary for trade and investments.

and the Philippines (a former American colony, it should be remembered) have accepted military aid. Soon after the Andijan crackdown in Uzbekistan, China offered its understanding to visiting President Islam Karimov, along with \$600 million in aid (previously negotiated) there. Similarly, human rights abuses have not prevented Cambodia from receiving \$200 million in Chinese loans.

China has promoted the Shanghai Cooperation Organization, in which Russia and most Central Asian states are members. Headquarters are in Beijing. Originally an anti-American talking club, the Chinese are pushing for some economic and military content, beyond joint exercises. Whether the Central Asians will agree to Chinese bases or advisers is doubtful, only if there is no greater outside threat, but aid and equipment are always welcome. Turkic Central Asians, aware of Chinese incursions in late antiquity, as well as overwhelming Chinese numbers, are understandably cautious about closer ties with this alien force. Proposals to join with China (or Russia) in trade matters have not yet been carried through.

## Return of the Russians?

Five of the CIS states, including Kazakhstan, Tajikistan, and Kyrgyzstan,<sup>35</sup> have created a “Eurasian economic community,” with the Russian Federation, intended to establish a unified external tariff, a common market for labor and capital, and a single set of regulations and preferences. A unified system of currency regulations and provisions against smuggling are also contemplated. However, Russian officials insist that such preferences will not prevent them from joining WTO, though a joint position among the five with respect to WTO matters is one objective, if Belarussian objections can be overcome. In the event, however, like all the other post-Soviet regional arrangements, the Eurasian Community stalled out around 2003, and was pushed aside by a Russian initiative for a “Single Economic Space.” This, too, has not shown much forward motion up to now. Note that Uzbekistan and Turkmenistan have consistently avoided these Russian and Kazakh-backed projects.

## Coordinated Multilateralism

Whatever preferential grouping is considered, trade diversion is usually a negative consequence to be avoided. That would occur if Central Asian countries were induced to import from ASEAN, the EU, or China instead of lower cost suppliers—India, Australia, Japan, or even North America for capital goods. Since Central Asian countries have low *de jure* tariffs, the most likely diversion would be through administrative preferences. One exception to the low tariff generalization is automobiles. Like Southeast Asia and India, which have created a protected market for assembling European brands, Uzbekistan produces Korean UzDaewoo sedans and minivans behind similar protection. A preferential RTA would exclude Japanese luxury makes from these markets, unless the Japanese succeed in their recent efforts to break in.

## The Costs and Benefits of Natural Protection

Central Asia is one of the most remote regions in the world, hardly the hinge of Asia, as Owen Lattimore once said. All the six countries are landlocked, Uzbekistan double-landlocked, and rail and

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<sup>35</sup> As of now, Belarus is the other member. Moldova and Ukraine are observers.

road transportation to ports are expensive and often interrupted by illicit stops by bandits and voracious border guards.<sup>36</sup> Bulk trade most commonly goes by rail to the Persian Gulf or to Russian ports, at considerable expense. Trade over Afghanistan or Pakistan by road would encounter security problems. It is scarcely likely that revival of the Great Silk Road will do much more for Central Asia than to bring a few wealthy tourists and hardy adventurers to the region because sea transport from the Far East is so much cheaper, if a little slower. Air cargo transport has hardly begun, though it would have the potential to help export fruits, vegetables, and flowers from the bountiful Ferghana Valley. Gold, uranium, and opium will of course also find a way. All these difficulties mean that the Central Asian region (including Xinjiang and parts of Siberia) constitutes a natural trading area for manufactured products of low value/weight. That would include many everyday goods—detergents, simple textiles, fertilizers—as well as agricultural machinery. The Central Asian states need only to open their borders to create trade in such items. They need fear little outside competition, except perhaps from Xinjiang. If the Central Asian governments could agree on a division of labor in manufacturing lines—for example, Uzbekistan produces cotton pickers, Kyrgyzstan combines, etc.—the area would benefit from economies of scale without keen competition from the outside, because of transportation costs and the CA low wage/productivity economies. All the governments need to do is commit to open markets and fair play for foreign investors. Agreements with the EU, ASEAN, or WTO might each of them promote this multilateralism and economic reform and with them, an expansion of foreign investment in the manufacturing, extractive, agricultural, and touristic potential of this developing region of the world.

## Policy Conclusions

Both theoretical reasoning and practical examples adduced here argue that the countries of Central Asia should liberalize their foreign trade on a nondiscriminatory basis without abandoning intraregional cooperation, which may involve sharing the market for such foreign investments as agricultural equipment, deepening intraregional transportation means, and possibly joint ventures. Owing to the natural protection of distance and transportation costs, a liberalized Central Asia would increase its intra-regional trade more than its extra-regional trade. Joining ASEAN, also on a MFN basis, would further facilitate both trade and investment in the area, while providing mentoring and nonthreatening discipline. For the intermediate future, the most promising trade partners within the region are oil-rich Kazakhstan and prosperous and energy-short Xinjiang PRC, with the expanding markets of Southeast Asia, Korea, India, Turkey, and Russia also worth pursuing more than slow-growing Europe. A liberalized Central Asia, especially one carrying out democratic reforms, would also qualify for more generous assistance from the EU, Japan, and international financial institutions.

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<sup>36</sup> See: G. Rabbalund, "Determinants of the Negative Impact of Being Landlocked on Trade: An Empirical Investigation Through the Central Asian Case," *Comparative Economic Studies*, Vol. 45, No. 4, December 2003, pp. 520-536. Curiously, this economist from the Sorbonne assumes Central Asian trade will go mainly to Europe. Land-lockedness seems to reduce trade on all continents some 75-80% from the volumes predicted by gravity models, apparently because of costs and delays of border crossings. That would be in addition to the costs of land haulage, roughly double that by sea (see: N. Limão, A.J. Venables, "Infrastructure, Geographical Disadvantage and Transport Costs," *World Bank Economic Review*, Vol. 15, No. 3, 2001, pp. 451-479).