THE INTEGRATION OF CENTRAL ASIA: ECONOMIC DIMENSIONS AND PROSPECTS. PART 1.

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The Integration of Central Asia: Economic Dimensions and Prospects

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Introduction

This is Part 1 of a two-part report which, together, represent a condensed version of the results from research conducted within the framework of a project bearing the same title and funded by the National Council for Eurasian and East European Research. The research was conducted from February through November 1997. In a more extended version, this subject will be treated in a book to be published in early 1998 by M.E. Sharpe and entitled Central Asia: the Cost of Independence.

The post-Soviet realm finds itself (and will continue to do so) in a position of instability and uncertainty. The centrifugal tendencies that initially prevailed after the collapse of the Soviet empire have since given way to tendencies toward integration. A multitude of ideas for integration have appeared, amidst a broad discussion of plans for federations, confederations, a Eurasian Union, and other forms of association. But until now, all these have been still-born. And this is because political motivations and interests prevail over economic realities. The process of regionalization in the post-Soviet space has only begun, although one must assume that the political map of Eurasia has already assumed its final form.

From the moment that the Soviet empire collapsed, the idea of creating a Central Asian regional union came to the fore. This notion arose as a counterpoint to the “Slavic Union” and as a reaction to the supercilious attitude of the three Slavic leaders, who had not seen fit to invite the leaders of Central Asia to Belovezhskai Pushcha and to give them a voice in the liquidation of the USSR.

During the first stages of post-Soviet transition in the Central Asian states, it was widely believed that the shift to a market system could be coordinated or, at least, closely tied to integration at the regional level. The small scale of national markets, the lack of direct access to sea transportation, the cooperative links inherited from the old Soviet system—all this, it seemed, would impel these states to embark on intensive mutual cooperation and to coordinate their economic policies. Moreover, as specialists from the German Foundation for Economic Development (who prepared a specialized study of regional integration in Central Asia) concluded, in the early 1990s the states here still shared a number of common characteristics that, in principle, should have served to facilitate large-scale cooperation. Specifically, they identified the following common features:

- a single Soviet past, whereby the experience of the Soviet era could serve as the basis for economic and social development in Central Asia;
- Russian language, as the lingua franca for all the countries of this region;
- similarities in the economic situation: despite considerable differences in details, none of the Central Asian economies had a higher level of competitiveness, and all the states find themselves at approximately the same stage of development;

Part 2 will be distributed by the National Council within a few days.
• the core of all the Central Asian economies is the production of primary goods for immediate export abroad; the creation of capacities to process these raw materials would help facilitate the process of market transition;

• the integrationist efforts in Central Asia could draw upon a common historical experience.¹

The idea of integration has been supported by political steps as well. In addition to participation in the CIS, which many post-Soviet leaders regarded as an intermediate step toward large-scale integration, three Central Asian states — Kazakhstan, Kyrgyzstan, and Uzbekistan — established the “Central Asian Union” in 1994. The main goal of the latter was to proclaim the creation of a single economic space for the participating states. In 1996, Tajikistan accepted the status of observer in this process. In the course of the entire post-Soviet era, there has been a steady stream of declarations; innumerable documents have been solemnly signed; and many regional summits have been convened. But thus far the upshot of all this has been more symbolic than practical. The complex interweaving of factors (from political interests to the use of natural resources), some dating back to the remote past and others only emerging in the post-Soviet era, has been a central element in this general stasis and apparent inability to resolve basic problems and rebuild elemental structures.

This paper examines the problem of economic cooperation of the Central Asian states in terms of practical realities. It deals with a complex of interrelated questions: what factors determine the need for cooperation among these states and what are the practical results of this cooperation? What tendencies dominate in the Central Asian economic zone—centrifugal or centripetal? To what degree is each state dependent upon its neighbors? And, most important, to what degree can regional integration (more precisely, regional economic cooperation) become a catalyst for economic growth in Central Asia?

This study consists of two main parts. The first presents an analysis of the current situation and dynamics of intra-regional commercial relations and the realities for economic cooperation by Kazakhstan, Uzbekistan, and Kyrgyzstan within the framework of the Central Asian Union. The second part considers the inclusion of the other two Central Asia countries — Turkmenistan and Tajikistan — in the intra-regional economic relations of this region: it also analyzes the role of geographic factors in intra-regional relations (specifically, the common use of water resources) and the transportation network (a factor of great significance for integration).

Part One

Summary

This section examines two factors of intraregional economic cooperation: (a) the level and dynamics of commercial relations among the countries of this region; and, (b) the realities of economic association of three Central Asian countries—Kazakhstan, Uzbekistan, and Kyrgyzstan—within the context of the Central Asian Union that they have created.

The key question is whether the intraregional trade is helping to create a regional economic bloc in Central Asia. The answer here is unqualifiedly negative. Indeed, things are moving in precisely the contrary direction. One statistical indicator of this centrifugal dynamic is the ratio between the trade volumes among the Central Asian states and the aggregate export-import flows. The data for 1994–96 clearly support the following conclusions. First, whatever group of Central Asian states one examines, the main tendency is the same: a decline in the significance of intraregional trade, especially with respect to exports. Given the growing determination of national producers to reorient toward markets with a real capacity to pay for their goods, one could hardly expect anything else. It can be said that the global ties of the Central Asian states increasingly take precedence over regional connections. Second, Central Asia—taken as a whole—constitutes a more integrated trading association than the Central Asian Union (Kazakhstan, Uzbekistan, and Kyrgyzstan). The latter is the most fragile trading association in the post-Soviet realm. Moreover, the trading ties among the Union’s three members, which were initially of marginal significance, have tended to decrease even further. Third, despite the breakup of the single Soviet economic space and the contraction of bilateral economic relations, the Commonwealth of Independent States (CIS) continues to represent a rather closely linked trade bloc. It is entirely obvious that the potential for expanding trade among the Central Asian countries is impeded by the similar structure of their export products. These countries produce approximately the same set of goods; hence their economic structures are not mutually complementary. Moreover, the potential for expanded imports from neighboring states is inhibited by a limited purchasing power and even the outright inability to pay for goods and services.

The leaders of Kazakhstan, Uzbekistan, and Kyrgyzstan have made declarations about the formation of a Central Asian economic union. Thus, in 1994, they established an Inter-governmental Council comprised of the heads of state; they also agreed to create a “single economic space,” removed customs barriers among themselves, and established a Central Asian bank for cooperation and development. The political benefits from demonstrating such consolidation are self-evident. Obviously, it is more effective to deal with Moscow as a united front rather than individually. But what is the practical implication of these matters? Does anything concrete stand behind these
gestures? Thus far, very little. And this is entirely predictable, for the region lacks such objective economic preconditions as export specialization (as in the Middle East), interest in a common market (as in Western Europe), or huge investment resources from one of the partners (as in the case of NAFTA).

**The Significance of Intraregional Trade in Central Asia**

Amidst the continuous investment decline, ubiquitous low level of internal savings, and the abundance of labor resources, about the only form of cooperation in Central Asia is trade. In 1996, the total export of the five Central Asian states was 13.78 billion dollars, which represented an increase of 1.56 times over the level two years earlier. The corresponding figure for total imports was 11.84 billion dollars (an increase of 1.34 times from 1994). By contrast, intraregional trade volume decreased. Thus, intraregional exports shrank from 2.1 billion dollars in 1994 to 1.4 billion in 1995; according to estimates, it fell to about 1.0 billion dollars in 1996. Similarly, intraregional imports contracted, falling from 1.9 billion dollars in 1994 to 1.6 billion the following year.

Uzbekistan and Turkmenistan were the main causes of the drop in intraregional exports. The former reduced its deliveries to the other Central Asian republics 4.4-fold (with an absolute decrease from 1.264 billion dollars in 1994 to 289 million dollars in 1996). Turkmenistan recorded a drop of 2.8 times (from 455.6 million dollars in 1994 to 161 million dollars in 1996). By contrast, the remaining three Central Asian republics—Kazakhstan, Kyrgyzstan, and Tajikistan—increased their exports to the region, but this growth could not offset the sharp contraction in exports from Uzbekistan and Turkmenistan.

As for imports, the total decrease (measured in value) was considerably less than in the case of exports. Indeed, four republics—Kazakhstan, Kyrgyzstan, Uzbekistan, and Tajikistan—reported an

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increase in imports from neighboring regional republics. Only Turkmenistan recorded a decline, as its intraregional imports fell from 103.3 million dollars in 1994 to 65.6 million dollars in 1996.

It bears emphasizing that the above indicators are based on the value of foreign trade in nominal dollars. If one takes into account the chaotic changes in domestic and foreign trade prices during 1991–96, the indicators for different years are not very comparable. The current statistical base does not enable one to reconstruct the dynamics of intraregional exports and imports for the first half of the 1990s in comparable prices and volumes; the requisite data are simply lacking.

Nevertheless, by the mid-1990s, the absolute volume of resources and goods in intraregional trade had clearly undergone a substantial decrease since the beginning of the decade. Thus, if one considers those branches that earlier constituted the basis of intraregional trade (such as electric power, natural gas, coal, and mineral fertilizers), the contraction in trade flows—if measured in physical terms—was ubiquitous. Thus, in the period of 1990–94, the intraregional trade in electric power fell from 60.3 to 13.3 million kilowatt/hours, i.e., more than 4.5 times. Sharp drops were also registered for natural gas (1.6 times in 1992–94), mineral fertilizers (more than 4.2 times in 1991–94), and coal (3.5 times).

The instances of an increased value in exports and imports, given the decrease in physical volume of trade turnover, were thus due exclusively to the price factor. Throughout the post-Soviet space (and in this regard Central Asia is no exception), foreign trade prices have gradually come to approximate those on world markets. Moreover, in most cases, the latter are higher than those that prevailed earlier within the USSR. Hence the growth in prices can compensate for the contraction in the physical volume of resources in the trade turnover. Although the road to equalizing internal and world prices is bumpy and twisting, it is clearly heading in that direction.

Given this fact, it is—in our judgment—pointless to talk about an increase of trade in post-Soviet space. Here one does not find a real growth in exports and imports but rather an increase in the monetary value of these foreign trade flows. By the end of 1996, the post-Soviet states have, essentially, applied world prices to their mutual trade. As a result, the monetary indicators for 1994–96 (almost without exception) are hardly comparable. Moreover, the more remote that they are from 1996, the less comparable they are.

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5To judge from fragmentary, preliminary data for 1995–96, the contraction of the physical volume of trade turnover, particularly for fuel and energy, has substantially slowed. Moreover, in the trade among some of the Central Asian republics, there has even been a certain increase in deliveries. For example, in 1995–96, Uzbekistan almost doubled its exports of natural gas to Kyrgyzstan, and in 1995 Tajikistan increased its exports of electric power to Uzbekistan. In general, however, the region has still not witnessed a stable tendency to increase the physical volume of intraregional trade.
The dependency of individual republics on intraregional trade varies considerably. Most dependent of all is Kyrgyzstan, but the situation is not much different in Tajikistan, which is especially dependent on its Central Asian neighbors for imports. In contrast to Kyrgyzstan (which depends, in roughly equal measure, on Uzbek and Kazakh deliveries), the Tajik imports come almost exclusively from Uzbekistan. In 1995, for example, Uzbekistan supplied 90 percent of the Tajik imports from the Central Asian Union and 75 percent of its total imports from the region as a whole. However, Tajikistan is far less dependent on intraregional trade for exports; in 1995, for example, it shipped less than 10 percent of its exports to Central Asian neighbors, with most of these goods going to Uzbekistan.

Uzbekistan, but especially Kazakhstan and Turkmenistan depend far less on intraregional trade. In 1994-96, the share of Kazakh exports to the Central Asian markets stabilized at a level of 6 to 7 percent, while the intraregional exports dropped sharply in the case of Uzbekistan (from 47.0 to 6.3 percent) and Turkmenistan (from 21.2 to less than 10 percent). These data demonstrate that Turkmenistan, which had been tightly integrated into the Central Asian economy (through natural gas and electric power deliveries), in recent years has reduced its trade with the neighboring states to a minimum. Kazakhstan moved in the same direction in the first half of the 1990s, and since 1995 Uzbekistan has done likewise.

This profound contraction in exports to neighboring markets is due to the disruption of the former deliveries of a noneconomic character as well as the reorientation of shipments to states capable of paying for such deliveries (for the most part, outside the former Soviet Union). For these reasons, there has been a sharp decrease in the share of intraregional imports of Uzbekistan and, especially, Kazakhstan and Kyrgyzstan.

What is the macroeconomic significance of intraregional trade for the individual countries of Central Asia? To answer this question, we have compared the export-import flows to the GDP of the individual states (calculated in US dollars on the basis of official exchanges for the individual national currencies). Notwithstanding certain problems and shortcomings in these data, they nonetheless make it possible to draw some interesting conclusions from an analysis of export-import quotients of GDP among the individual countries and regions.

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6One must, however, treat these indicators with due caution—in the first instance, because the nominal dollar volume of GDP largely depends on policies with respect to the official exchange rate, which can be subjected to unpredictable changes. Thus, for example, Uzbekistan and Turkmenistan regulate the exchange rate through administrative measures; hence it is impossible to predict how the Uzbek sum and the Turkmen manat will behave in the event of liberalization. In 1994-95, Kyrgyzstan essentially fixed the nominal exchange for the som, which was used as an anchor in its anti-inflationary policy. However, the rate set for the som against the dollar was unduly high; lacking the support of a favorable balance of trade and payments, it relied more on foreign loans.
It turns out that Tajikistan is the country most dependent on trade with its neighbors in the region. In 1995, the proportional share of Tajik exports sent to Central Asian markets amounted to 23.8 percent of its GDP, while its imports from this region were more than half its GDP. If one uses these data outright (without the requisite corrections), in 1995 both exports and imports exceeded the nominal dollar value of the GDP. In the case of imports, this situation had already become apparent the previous year.

Such a situation is obviously the consequence of the existing under-assessment of the GDP by the national statistical services. The local labor force, resources, and raw materials used to produce the final export goods (as well as the intermediate production) are all undervalued, while the final product is calculated essentially in terms of world prices.

At the same time, it would be wrong to reduce all this to technical shortcomings in the national statistics. Indeed, the situation with respect to export and import quotients of the GDP in Tajikistan is not simply a technical error, but reflects the special economic realities in the country. Namely, this country simply does not have a single national economy: its economic space is decentralized along regional and clan lines, with economic assets (including exports) openly serving criminal and/or off-shore companies and organizations.

Foreign trade, under these circumstances, is completely isolated and detached from the domestic economy. The people who really control export enterprises (indeed, who are not necessarily the formal, legal heads of these businesses) are concerned only about enriching themselves in the shortest possible time and are willing to resort to any methods whatsoever. In using local resources and labor for export production, they in turn do not return the earnings to the national economy. Export revenues simply flow into private bank accounts held abroad. It will be no easy matter to demolish this structure of social-economic interests and to reestablish export production as part of the national economic turnover.

Moreover, it turns out that the significance of intraregional trade is almost as small in Kazakhstan as it is in Turkmenistan. Thus, the regional exports (as a percent of the GDP) amounted to just 2.0 percent for Kazakhstan (1996) and 3.8 percent for Uzbekistan (1995); the analogous figures for imports were 1.8 percent for Kazakhstan and 1.6 percent for Turkmenistan. This is due to the dynamics of the dollar value of the Kazakh GDP, which grew much more quickly than did exports and imports. In Turkmenistan, one finds a substantial growth in the nominal dollar value of

\footnote{For example, according to some sources, the largest enterprise and main source of hard-currency earnings in Tajikistan is the aluminum plant in the city of Tursunzade, which is under the control of corrupt elements. The republic budget receives only 10 percent of the plant's earnings; the rest is distributing among its real bosses—Ekaterina Sytaia and Takhir Dzhalilov. “Srok ultimatuma Sodirovu istek,” Nezavisimaia gazeta, 21 March 1997, p. 3.}
the GDP, set against a background of a decline in the absolute volume of trade, especially with former Soviet republics, including those in Central Asia.

Until 1996, Uzbekistan occupied an intermediate position between Kazakhstan and Turkmenistan on the one hand, and Tajikistan and Kyrgyzstan on the other. In 1996, the exports to Central Asian markets amounted to just 2.1 percent of the GDP, a figure that represents a ten-fold decline since 1994. The import quotient of the GDP also fell to 2.0 percent of the GDP, a decrease of 4.5 times. In other words, Uzbekistan’s dependence on intraregional trade has become as insignificant as in the case of Kazakhstan and Turkmenistan.

Therefore, the key question is whether the intraregional trade will help to create a regional economic bloc in Central Asia? The answer here is unqualifiedly negative. Indeed, things are now moving in precisely the opposition direction. A statistical indicator of this centrifugal dynamic is the ratio between the trade volumes among members of the Central Asian Union, on the one hand, and the aggregate export-import flows on the other. The authors have compiled such data for the years 1994–96.

These data clearly sustain several important conclusions. First, whatever group of Central Asian states one examines, the main tendency is the same: the significance of intraregional trade is decreasing, especially with respect to exports. Given the growing determination of national producers to reorient toward markets with the capacity to pay for their goods, one could hardly expect anything else. It can be said that the global ties of the Central Asian states increasingly take precedence over regional connections.

Second, Central Asia—taken as a whole—constitutes undoubtedly a more integrated trading association than the Central Asian Union (Kazakhstan, Kyrgyzstan, and Uzbekistan). The latter is the most fragile trading association in the post-Soviet realm. Moreover, the trading ties among the Union’s members, which were of little significance at the outset, have tended to decline even further. If in 1994 the proportion of mutual exports among these three countries constituted 12.2 percent of total trade, in 1996 it had fallen to 6.9 percent. A similar decline is apparent in imports, which fell from 10.4 to 7.9 percent during the same period. For Central Asia as a whole (for the years 1994–95), intraregional exports fell from 21.1 to 13.5 percent of total trade, with a smaller decrease in the same indicator for imports (dropping from 20.8 to 17.9 percent).

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Third, despite the breakup of the a single Soviet economic space and the contraction of bilateral economic relations, the CIS continues to represent a rather closely linked trade bloc.

What are the immediate prospects for commercial cooperation of the Central Asian states? Have the centrifugal tendencies of the early 1990s run their course and given way to the reverse tendency?

An examination of the branch structure of foreign trade in Central Asian states shows that the main exports from Kazakhstan, Tajikistan, and Turkmenistan consist of oil and natural gas, oil distillates, electric power, and ferrous and nonferrous metals. In 1996, these goods accounted for 68.7 percent of the aggregate exports from Kazakhstan, 72.8 percent from Turkmenistan, and 69.2 percent from Tajikistan. The main export from Uzbekistan is cotton, followed by electric power and natural gas. Only in Kazakhstan are exports more or less diversified so as to include agricultural products as well as goods from the foodprocessing and textile industries.

Moreover, the structure of exports of these five states remained stable during the period of 1994-96. Because of the continuing investment crisis in the region, it is difficult to imagine that this structure will change in any fundamental way in the next five or ten years.

It is entirely obvious that the potential for expanding trade among the Central Asian states is impeded by the similar structure of their export products. To repeat, these states produce approximately the same set of goods; hence their economic structures are not mutually complementary. Moreover, the potential for expanded imports from neighboring countries is inhibited by the limited purchasing power and even the outright capacity to pay for goods and services.

At the same time, one must take into account a very important circumstance: exports and imports of the five Central Asian states are rather tightly bound to a limited number of markets. Thus, in 1996, the three main export partners of Kazakhstan accounted for 57.1 percent of the country's aggregate exports.

However inconsequential the deliveries to neighboring countries might be, all five of the Central Asian states (including Kazakhstan, Turkmenistan, and Uzbekistan) nonetheless make it a high priority objective to retain these export markets. And two countries—Kyrgyzstan and Tajikistan—have no realistic alternative to the development of intraregional trade.

Revealingly, the official statistics fail to capture and report certain commercial transactions among these countries. It is well known, for example, that mutual trade flows can be established in either of two ways: either on the basis of data from the exporting country, or on the basis of data from the importing country. Ideally, one should create both sets of data, with one side being the mirror image of the other. In other words, the data on exports from Kazakhstan to Uzbekistan should be identical to the data on imports to Uzbekistan from Kazakhstan. In the case of the Central Asian republics, however, the two sets of data do not coincide and indeed reveal a substantial gap. A
similar situation obtains throughout the entire post-Soviet realm. Thus, in the trade of Central Asia with Russia, the official statistics “lose” about 1 billion dollars.

Extra-legal, and extra-statistical, is the turnover in the underground channels of intraregional trade in Central Asia, a “shadowy sphere” representing about 15 to 20 percent of the officially registered indicator. For all practical purposes, this turnover has involved almost exclusively unregistered financial-commercial and industrial groups, and it does not appear in the flows of resources and goods reported by the national statistical services. A significant factor in the trade turnover of the shadow economy also belongs to the so-called “shuttle traders” (chelnoki)—the hundreds of thousands of people who regularly journey abroad, including neighboring states, to engage in such trade.

Some idea of the absolute scale of unregistered exports and imports can be gleaned by comparing official statistics with the data on balance of payments (which, in fact, provide a more accurate picture of export-import flows). In Kazakhstan, for example, in 1996 the statistics on customs showed an export volume of 6.23 billion US dollars, but the balance of payments reported 6.32 billion dollars; official records on imports listed 4.26 billion dollars, but the balance of payments amounted to 7.09 billion dollars. Thus, to quantify these results, the case of imports reveals that official records captured only 60 percent of total imports.

It is difficult to say whether the shadow imports will continue to run at such a high volume. If the national governments are able to establish strict control over this informal shadow trading, it is likely that the volume will sharply decrease. It is no secret that, from a macroeconomic point of view, uncontrolled trade flows are inefficient and often unprofitable. They exist only as a mechanism for diverting national resources and budget revenues into private hands.

The Central Asian Union: Economic Cooperation

In 1996, the trade turnover among the members of the Central Asian Union—Kazakhstan, Kyrgyzstan, and Uzbekistan—stood at 1.4 billion US dollars. The three trade partners had roughly equal shares of this trade: of the Union’s trade turnover, 34.7 percent belonged to Kyrgyzstan, 34.5 percent to Kazakhstan, and 30.8 percent to Uzbekistan. In general, the dynamics of trade turnover for 1994–96 show a stabilization in the mutual export-import flows of the three members of the Union. In terms of the bilateral shares of trade, in 1996 the trade of Kazakhstan and Uzbekistan accounted for 44.1 percent of the Union’s total turnover, Kazakhstan-Kyrgyzstan trade represented 31.8 percent, and Uzbekistan-Kyrgyzstan amounted to 24.1 percent.9

9Data here are drawn from the sources cited above, in notes 3 and 8.
A closer analysis of Kazakhstan’s trade with the other two members — about three-fourths of all export-import transaction in the Union — provides a clear picture of the flow of goods among the three states. The lion’s share of trade turnover belongs to fuels, grain, and electric power. Thus, in 1996, grain, flour, and groats accounted for 34.5 percent of the Kazakh exports to Uzbekistan, with another 18.3 percent belonging to salt, sulphur, and lime. That same year, Kazakhstan’s exports to Kyrgyzstan consisted mainly of fuel and petroleum products (47 percent), followed by grain, flour, and groats (18.6 percent). In turn, two-thirds of Kazakhstan’s imports from Uzbekistan consisted of natural gas, fuel, petroleum distillates, and electric power. Its imports from Kyrgyzstan consisted mainly of electricity, beverages, sugar, and confectionery products.

Although the mutual deliveries of petroleum products and grain have significantly decreased within the framework of the Central Asian Union, the mutual dependency for electric power and water has remained important. And the exchange of water, electricity, natural gas, and coal are all closely interrelated.

Ever since the Soviet era, the electric power plants of Kyrgyzstan—with its hydroelectric complex on the Naryn River—have coordinated their operations with the agricultural cycle of Uzbekistan and Kazakhstan. In the fall, winter, and early spring each year, the largest reservoir (Toktogul) accumulates its water reserves, which are then sent in the summer to the plantations in the Uzbek part of the Fergan Plain and to the rice fields of Kazakhstan (Kzyl-Ordin and Iuzhno-Kazakh Oblasts). For its part, Uzbekistan purchased electric power from Kyrgyzstan and in return delivered natural gas; Kazakhstan paid for its water by delivering coal from the Ekibastuz coal fields. Coal and natural gas, in turn, enable Kyrgyzstan to generate electricity at thermal power plants during the winter.

Such a complex system of mutual deliveries takes into account the specific and differing interests of the partners. By the mid-1990s, Uzbekistan was using 59 percent of the electric power generated from the Naryn hydroelectric plants, and Kazakhstan took another 27 percent. As a result, Kyrgyzstan itself used only 14 percent of the power that it was producing.

In the first years after the breakup of the USSR, this system of mutual deliveries—which had been built up over many years—suffered serious disruptions. Kazakhstan and especially Uzbekistan continued to receive water from Kyrgyzstan, but periodically failed to deliver coal and natural gas, citing their own internal difficulties. Both states also cut back sharply on purchases of electric power from Kyrgyzstan.

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That forced Kyrgyzstan to reply in kind. During the summer, the Toktogul hydroelectric station—rather than cut back on the production of electricity and accumulation of water—continued to work at full capacity, utilizing water resources intended for the irrigation of crops. The result was a situation fraught with unpredictable consequences. The Toktogul reservoir is the key artificial body of water in the Naryn and Syr-Daria hydroelectric system; it is also a reservoir for long-term regulation of water flows. In other words, the volume and level of water in this reservoir determines the situation at all the hydroelectric stations lower on the Naryn and Syr-Daria, as well as the functioning of the agricultural sector in Uzbekistan and Kazakhstan.

Simultaneously, Kyrgyzstan raised the issue of charging fees for the use of water resources. In the middle of 1996, the parliament of Kyrgyzstan dispatched a special message to its counterparts in Kazakhstan, Uzbekistan, and also Tajikistan—i.e., those states that draw water from the Syr-Daria and smaller streams in its basin. This note pointed out that, because of the unequal distribution of water resources in the region, the bulk of these were concentrated in Kyrgyzstan (in the mountainous mass of Ala-Too); it is in these mountains that the Syr-Daria begins, forming the water resources for four states, including the densely populated Fergan Valley. Of the 47 billion cubic meters of water collected on the territory of Kyrgyzstan, only one-quarter is used within that country; the remaining 75 percent goes to Uzbekistan, Kazakhstan, and Tajikistan. Yet Kyrgyzstan alone has had to devote substantial resources—at least 70 million dollars per year—to maintain the complex hydro-technical, irrigation, and hydroelectric plants and facilities. In addition, complained Kyrgyzstan, there are various indirect costs as well as opportunity costs (e.g., some 46,000 hectares of fertile land had to be flooded to create these reservoirs). In short, the large water reservoirs like Toktogul, Andizhan, Papan, Kerkidon, Kirov, Orto-Tokoi, and Kasansai are located on the territory of Kyrgyzstan, but service mainly the neighboring states of Uzbekistan and Kazakhstan. Moreover, during the winter months, the Naryn hydroelectric complex—rather than produce electricity—accumulates water to supply the fields of the neighboring states in the following summer. Kyrgyzstan estimated the total losses and profits foregone at 60 million dollars. The neighbors, by using these water resources, have increased their cultivated land area by more than 7 million hectares. Given these circumstances, Kyrgyzstan proposed that all the water consumers of the region share this burden\(^\text{12}\) and, in effect, raised the question of monetary fees for the use of transnational rivers. As the first step in this process, it began to levy fees for water use within its own territory.\(^\text{13}\)

The ensuing discussions resulted in a compromise. To pay for its use of water, Uzbekistan increased (or, more precisely, restored to the 1993 levels) the delivery of natural gas to Kyrgyzstan.


and at prices substantially lower than those prevailing on world markets.\textsuperscript{14} A mutually acceptable compromise was found, after difficult confrontations, for other residual problems.

Some foreign observers maintain that, in 1992–95, Uzbekistan sought to exploit the dependence of its neighbors in the sphere of fuel and energy to exert a certain pressure, in political matters as well.\textsuperscript{15} They argue that this pressure, while not publicly advertised, took the form of Uzbek pretensions to exercise leadership in the region. These pretensions are usually seen in terms of Uzbekistan's overt attempts to supplant Turkmenistan as the main supplier of natural gas in the region.

The present authors, however, hold a somewhat different view of the mutual relations in the complex issue of natural gas and energy. Turkmenistan, which aspired to become a "second Kuwait" in the Central Asian framework, sought to abandon insolvent consumers who, in effect, could pay for large deliveries of natural gas only through some form of barter. By early 1994, Kazakhstan's debts to Turkmenistan for natural gas deliveries had already come to exceed 60 million dollars.\textsuperscript{16} Moreover, even these payments in kind were irregular, being neither in full nor on time. Frequently, Turkmenistan had to resort to extreme measures to obtain what it was due. It is highly revealing, for example, that Kazakhstan agreed to extinguish its debts to Turkmenistan (amounting to 24.3 million dollars) through the delivery of asbestos, phosphorus, lead, copper rods and various other barter goods in March 1997.\textsuperscript{17} In addition, Turkmenistan already had analogous problems in its relations with Ukraine and the Caucasus republics, which continue to be large-scale users of natural gas, but are in no position to pay for it. However, Turkmenistan was unable to shut off Kazakhstan completely from natural gas deliveries for the simple reason that the pipeline to Europe (which can pay for what it consumes) passes through the territory of Kazakhstan.

Under the circumstances, it was entirely natural to substitute Uzbek gas for that from Turkmenistan. That is all the more appealing because the natural gas pipeline that runs through the Central Asian republics also passes through Uzbekistan, and that republic is far more dependent on trade with its neighbors than is the case with Turkmenistan. If Uzbekistan had any political calculations behind this decision, these were only an auxiliary factor to the basic economic

\textsuperscript{14}Delovoi mir, 15 January 1997, p. 2.


\textsuperscript{17}"All over the Globe," Vremia po Grinvichu (Almaty), no. 22 (21 March 1997), p. 2.
considerations. It is quite another matter that, almost immediately, Uzbekistan found that neither Kazakhstan nor Kyrgyzstan was able to pay for the gas deliveries. By the end of 1994, Kazakhstan’s debts for Uzbek gas had already mushroomed to 138 million dollars.\(^{18}\) Kyrgyzstan’s debts for the delivery of Uzbek gas constantly ran in excess of 1 million dollars.\(^{19}\) Such a high level of indebtedness was due to the fact that Uzbekistan was constantly seeking to raise the price to world market levels. In 1994, Kazakhstan obtained its natural gas at the price of 80 to 84 dollars per thousand cubic meters, compared to 100 dollars on world markets.\(^{20}\)

In an effort to force its debtors to pay, Uzbekistan began to interdict, on a regular basis, its deliveries of natural gas.\(^{21}\) Naturally, Kazakhstan and Kyrgyzstan promptly resorted to counter-measures. For Kyrgyzstan, the most powerful economic argument in its dialogue with Uzbekistan was of course the latter’s dependence on its water. Moreover, these two countries have concluded agreements on payments, which provide for a mixed form of payment in the form of money and clearing deliveries.\(^{22}\)

For its counter-arguments to Uzbek pressure, Kazakhstan used the indebtedness of Uzbek firms that shipped freight on the Kazakh railway lines, as well as Uzbekistan’s debts for grain imports. For example, in February 1996, the Uzbek debt for rail services was estimated at 160 million dollars.\(^{23}\) Until recently, Uzbekistan has also remained highly dependent on Kazakhstan for grain imports, parts of which were used for clearing transactions in bilateral inter-governmental agreements.\(^{24}\) As a result, Kazakhstan forced the Uzbek government to cut the export price of natural gas to 50–55 dollars per million cubic meters.\(^{25}\)

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\(^{20}\) Ibid.


\(^{22}\) *Delovoi mir*, no. 10 (6–12 September 1996), p. 4.

\(^{23}\) “Zheleznaia doroga—ne doinaia korova,” *Azsia—ekonomika i zhizn’*, no. 7 (February 1996), p. 17.


The problems described above, along with many similar difficulties in mutual accounts, cannot be resolved on the level of indirect producers and users, the majority of whom have a limited capacity to pay. At the same time, throughout the post-Soviet realm one finds that end-users do not pay for the delivery of electricity and energy. To settle the interstate claims that over time have accumulated, it is necessary for states and presidents to intercede directly; only they are in a position to control the flows of financial and physical resources at the macro level by taking decisions to liquidate natural gas debts against the debts for rail freight services, or by reaching agreements for clearing on terms that deviate substantially from world prices. The transitional character of the Central Asian economies, which (for a number of reasons) will continue for several years, makes the intervention by political authorities necessary. Sooner or later, however, such political intercession will have to abate and disappear.

Since 1996, the government of Kazakhstan, for example, has finally renounced any responsibility for users' failure to pay for natural gas. As a preventive measure, already in November 1995 Uzbekistan sharply curtailed the export of natural gas in order to avoid a situation where it was unclear who, in the final analysis, will pay for its gas deliveries.26

In strategic terms, palliative and extra-market measures to regulate bilateral economic relations run counter to the very logic of reforms now being adopted in both Kazakhstan and Kyrgyzstan. Even without these measures, both countries had long since surpassed Uzbekistan in terms of economic liberalization and institutional restructuring through privatization, but in 1996–97 they took additional decisive measures for the final demolition of a planned, distribution economy based on the Soviet model.

Recently, there has been a striking upsurge in the scale of Kazakh-Kyrgyz ties. It is tempting to interpret this either as a covert struggle for regional leadership between Kazakhstan and Uzbekistan, or as an attempt by Kyrgyzstan to compensate for its relative weakness in the dialogue with Uzbekistan. While both motives must not be discounted, the present authors believe that the formation of the Kazakh-Kyrgyz tandem has a solid economic basis. In terms of the type of economic policy and the institutional structure taking shape in both states, these two countries are without question far more similar to each other than to Uzbekistan, which has deliberately chosen a separate, unique line of development. Kazakhstan and Kyrgyzstan are also drawn closer by the fact that their political regimes are far more democratic and distinguished by complete openness and transparency.

As for the influence of politics, the close cooperation among the Central Asian states depends not only on regional, but on the larger schema of post-Soviet forces and interests. The demonstrative

closeness of Kazakhstan and Kyrgyzstan, which have formed a customs union, began to gain momentum in response to the closer ties between two other members of this union, Russia and Belarus. Given their critical dependence on trade with Russia, neither Kazakhstan nor Kyrgyzstan is particularly interested in reinforcing that dependence through political or, especially, military-strategic ties. Hence the formation of a dual Slavic alliance precipitated the formation of a Central Asian tandem. As Nursultan Nazarbaev unambiguously declared: “If a center of consolidation is created in the European part of the CIS, we will strengthen the Central Asian Union.”

The closer ties between Kazakhstan and Kyrgyzstan do not signify, however, that their bilateral relations are devoid of contradictions and competition. From time to time, Kyrgyzstan exploits the fact that Uzbek natural gas flows to Kazakhstan through a pipeline passing through Bishkek: namely, it claims part of the Kazakh quota of gas delivers—much as Ukraine does on Russian gas destined for Europe. In 1995, the two sides conducted difficult negotiations on the question of extinguishing Kazakhstan’s debt of 45.5 million dollars for electricity from Kyrgyzstan. On the basis of mutual concessions, Kyrgyzstan agreed to reduce the price on this electricity by almost half (from 3.5 to 1.9 cents per kilowatt/hour). Only under open pressure from Kyrgyzstan did Kazakhstan agree to consider the question of creating a single energy pool for the two countries and to participate in the construction of electric power plants on Kyrgyz territory.

One cannot overlook the fact that Kazakhstan, with transparent envy, looks askance at Uzbek-Kyrgyz plans to construct a rail line from Andizhan (Uzbekistan) through Osh and Irgeshtam (Kyrgyzstan) to Kashgar (China). This new line will not only link China to Central Asia (and, then to Europe) but will do so by skirting the territory of Kazakhstan.

As the above data show, relations in the Central Asian Union (and in the region more generally) are far from idyllic. From time to time, the members of the Union become locked in serious disputes over the payment and use of natural resources. In principle, a similar picture obtains all across the post-Soviet realm.

Fundamentally, all the states of the region, with the exception of Tajikistan, for obvious reasons aspire to make themselves self-sufficient in energy resources. Without doubt, they will do

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this as soon as they have the requisite financial resources. To be sure, the mutual trade in the region
and the cooperation in production (at the level of individual enterprises) will not entirely disappear.
Still, this trade will be based on purely market terms and on a significantly smaller scale than is now
the case.

The growing openness of Central Asian economies to world markets will gradually efface the
force of intra-regional dependencies. For example, in 1995–96, Uzbekistan became reoriented
toward the purchase of grain from sources outside the CIS and thus began to replace imports from
Kazakhstan. The reason is that, on world markets, it obtains certified grain of high quality on
incomparably more favorable terms than those offered by Kazakhstan.32

Central Asia is perfectly aware of these new tendencies. It is revealing, for example, that Serik
Primbetov (first chairman of the Executive Committee of the Inter-State Council of the Central Asian
Union) should have made the following statement: “One should not measure everything in terms of
economic parameters alone; our union represents more a union of spiritual values.”33

The Central Asian Union is engaged not only in resolving disputes that periodically erupt or in
regulating questions that date back to the Soviet era, when Central Asia as a whole (and, in part.
Kazakhstan) functioned as a single economic complex. At the level of presidents and governments,
they have created a concrete program for cooperation that involves more than fifty new joint,
collaborative projects.

The realization of these new projects, however, requires investment. To attract this capital, the
participants of the Central Asian Union have created a “Central Asian Bank for Cooperation and
Development” (Tsentr'noaziatskii bank sotrudnichestva i razvitiia, or TsABSR). This bank is to
play the role of an informational and analytic center, but above all to function as an investment
mechanism and thereby convert integrationist rhetoric into practical reality.

At this point, the Bank has granted several small credits. These include 300,000 dollars to an
Almaty corporation “Saiman” (to produce electric meters), 300,000 dollars to the Uzbek firm
“Farmprom” (to organize the production of blood products), and 300,000 dollars to a Kyrgyz
corporation “KEMZ” (to manufacture household and industrial-grade electric motors).34 The
volumes of financing demonstrate clearly that these joint collaborative projects have basically a
symbolic character. Nor can one expect any signal breakthroughs from this bank in the immediate

32“Novyi finansovyi menedzhment pozvolit reshit’ mnogie strategicheskie i takticheskie zadachi,”

33Karlygash Ezhenova, “ES gotov peredat’ nou-khau ekonomicheskoi integratsii Kazakhstanu,

34“Potentsial vzaimovygodnogo sotrudnichestva dolzhen byt’ ispol’zovan spolna,”
future, for its investment potential is exceedingly modest. Significantly, by January 1997, the participating countries had given the bank only about two-thirds of its charter capital—which, indeed, was already modest to begin with.\textsuperscript{35} In short, its resources are absolutely inadequate for meeting the investment needs of Kazakhstan, Uzbekistan and Kyrgyzstan.

This bank has neither become (nor is it likely to become) a serious channel capable of drawing unencumbered means from world financial markets for investment in Central Asia. That role is far more likely to be exercised by established institutions such as the World Bank, the Asian Development Bank, and the Islamic Development Bank.

In April 1997, Uzbekistan openly expressed disillusionment with the work of the Central Asian Bank for Cooperation and Development.\textsuperscript{36} That disenchantment derived from two main considerations. First, the Bank—as a commercial bank—requires state guarantees for projects that it funds. The government of Uzbekistan, however, contends that its contribution to the charter capital should be treated as its state financial guarantee for loans. Second, because of the special characteristics of the hard-currency system of Uzbekistan, for all practical purposes Uzbek enterprises cannot make use of credits from this bank: the latter issues credits in freely convertible currency and demands repayment in the same. Whereas borrowers in Kazakhstan and Kyrgyzstan have no difficulty converting their earnings from the national currency into dollars, enterprises in Uzbekistan encounter serious obstacles to turning their profits into hard currency.\textsuperscript{37}

In general, the fundamental incompatibility in the differing national systems for currency regulation constitutes a formidable barrier to the development of Uzbekistan’s cooperation with Kazakhstan and Kyrgyzstan. Despite the constant pressure of its partners in the Central Asian Union, Uzbekistan categorically refuses to sign an agreement on mutual convertibility of national currencies.\textsuperscript{38} In the autumn of 1996, as Uzbekistan encountered serious difficulties in its balance of

\textsuperscript{35}“Otchet Tsentr’noaziatskogo bank sotrudnichestva i razvitiia po vypolneniiu reshenii Mezhgosudarstvennogo soveta Respubliki Kazakhstana, Kyrgyzskoi Respubliki i Respubliki Uzbekistana,” \textit{Azii—ekonomika i zhizn’}, no. 5 (February 1997), p. 3.

\textsuperscript{36}Iurii Galymov, “Problematichnyi kapital,” \textit{Delovoi mir}, 3 April 1997, p. 3.

\textsuperscript{37}Although the Central Bank of Uzbekistan formally conducts such conversions at the official exchange rate, in practice this transaction must overcome a host of administrative and, especially, arbitration hurdles. As a result, conversion of earnings to hard currency even represents a problem for the daughter firms of transnational corporations. Predictably, small and medium-sized domestic producers are virtually excluded from such conversion transactions.

payments (and hence in its capacity to support the official exchange rate on the sum). Uzbekistan reduced transactions through correspondent accounts that financial institutions of CIS countries had opened in banks on its territory. Naturally, the National (Central) Bank of Kazakhstan responded by suspending quotations on the exchange rate between its tenge and the Uzbek sum.39

The incompatibility of macroeconomic policy and structural factors also makes it difficult for Kazakhstan and Uzbekistan even to reach agreement on the terms for bilateral trade. Thus, Kazakhstan regards commercial relations with Uzbekistan within the framework of most favored nation status, while Uzbekistan wants a system of free trade.40

Desiring to marketize the barter trade (at least formally), in April 1996 the presidents of the member countries of the Central Asian Union authorized their state banks (the National Bank of Kazakhstan; the National Bank of Kyrgyzstan; the Central Bank of Uzbekistan) to establish and run clearing chambers in Almaty ("Kazakhstan-Kyrgyzstan-Uzbekistan"), in Bishkek ("Kyrgyzstan-Kazakhstan-Uzbekistan"), and in Tashkent ("Uzbekistan-Kazakhstan-Kyrgyzstan"). Moreover, it was expected that these chambers, in a short period of time, would develop branches in other cities of these republics.41 Given the factors cited above, however, one cannot expect any substantial results from this agreement.

In Kazakhstan, for example, the domestic prices on natural gas and grain have been almost totally deregulated and are now regulated by the market. In addition, the state has declined to subsidize either producers or consumers. Hence it is virtually impossible to create special, quasi-market (but in reality centralized) systems of cooperation (with their own prices and terms for delivery); this applies to transactions with any state, including Uzbekistan. Thus, Kazakhstan's grain is freely available for purchase on the exchange, along with all the requisite licenses for export. In 1996, Uzbekistan came to rank as the second largest buyer—after Russia—of grain at the International Kazakhstan Agro-Industrial Exchange.42

Evidently, the idea of creating a mechanism for investment cooperation to stimulate the development of commercial ties in new spheres, while basically a sound conception, has nonetheless

foundered. There were two main reasons for this. First, and fundamentally, not a single member of the Central Asian Union has the unencumbered investment resources to allocate for such general development. Second, confronted by a collapse of investment, all three countries adamantly insist that the Central Asian Bank for Cooperation and Development allocate resources proportionate to their individual contribution to the bank’s charter capital. Amidst the acute shortage of capital, no one intends to use his scarce resources to help someone else. Hence the profitability of concrete projects, and their significance in the middle or long term, are not taken into account.

A close analysis of the collaborative projects shows that this program has done nothing more than mechanically combine the proposals of numerous ministries and state agencies. In fact, this amounts to a mere list of possible spheres of bilateral and trilateral cooperation that happened to be under official review at the time the program was prepared. It is clear that considerations like economic efficiency and significance for regional development did not play a role in the preparation of this program. It is no accident that some of the officials involved in multilateral cooperation have expressed serious doubts about the feasibility of some of these cooperative projects.\(^\text{43}\) Even the most important projects have gone unrealized. Thus, the construction of the natural gas pipeline “Gazli-Bishkek-Almaty” in 1995–96, for lack of funds, could not be undertaken; to complete this work on their respective territories, Kazakhstan needs 10 million dollars and Kyrgyzstan 5 million dollars.\(^\text{44}\)

For these same reasons, prospects for the creation of transnational companies and financial-industrial groups in Central Asia are not promising. For example, more than thirty Kyrgyz, Uzbek, and Kazakh enterprises have announced plans to create an industrial group called “Tsentrzelektron,” which would combine enterprises from the electronics, radio, and instrument-manufacturing industries that had, in the Soviet era, been part of the military-industrial complex.\(^\text{45}\) However, in seeking to establish relations on a market basis, these enterprises have inevitably encountered the problem of mutual payments, an issue that cannot be resolved at the micro level, but rather requires compatible macroeconomic policies by the states involved.

In principle, the prospects are brightest for those enterprises in the region that have been created by foreign capital and that form a vertical chain of production. For example, the South Korean company Daewoo created an auto assembly plant in Uzbekistan and included (or plans to do


\(^{44}\)Ibid.

so) several Kazakh and Kyrgyz enterprises into a single production cycle. However, so long as the member states of the Central Asian Union have substantial differences in currency controls, foreign capital is forced to resolve problems of inter-enterprise payments by lobbying directly at the highest instances of political authority. And the very fact that such projects bear the imprint of exclusiveness and subjective treatment means that they cannot become the locomotives of development for the national economies.

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