

## Background Study

### Conference – Central Asia and Europe: A New Economic Partnership in the 21<sup>st</sup> Century

#### IMPROVING THE BUSINESS AND INVESTMENT ENVIRONMENT THROUGH TECHNICAL ASSISTANCE FOR REGIONAL ECONOMIC COOPERATION

Prepared by a regional expert group<sup>1</sup>

##### *Box 1. Executive summary*

Europe, and within it the European Union, is the largest trade and investment partner of Central Asia and at the same time an important donor. Well-targeted and well-coordinated technical assistance – delivered in cooperation with the UN and other members of the international development community in key areas of regional economic cooperation – can effectively contribute to the faster development of trade and investment links between Central Asia and the EU and other important economic partners. The strengthening of market-based mechanisms for energy deliveries - possibly in the form of a regional water-energy consortium - and intensive training of government officials and experts in cooperative water management could remove one of the most persistent obstacles to regional cooperation – controversies over water and energy. Intensive technical assistance to the harmonization trade-related agreements and overall liberalization of international trade, as well as assistance to trade facilitation, including trade and transport facilitation measures, like streamlined and transparent border crossing procedures would remove present obstacles to intraregional trade and ensure better access of Central Asian companies to world markets. Technical assistance to the development of Eurasian transport corridors, the gradual adoption of international legal instruments and norms for transport management would remove a significant bottleneck hindering the delivery of Central Asian exports to Europe and other important markets. Technical assistance to the development of regional clusters covering manufacturing, agriculture, agricultural processing and services would significantly contribute to increasing the competitiveness of Central Asian producers and companies. The above measures would effectively contribute to a positive regional business and investment climate and a more effective contribution of intra- and extra-regional investment to the diversification of the economies of Central Asian countries. Consequently these measures would lead to the sustained development and stability of the region.

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<sup>1</sup> This document uses primarily data from Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. For the purposes of the study, “Central Asia” consists of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. The “SPECA region” includes in addition Afghanistan and Azerbaijan.

##### **Disclaimer:**

The content of the paper does not represent the official position of the UNECE or its Member States and reflects the views of the authors only.

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## INTRODUCTION

This document was prepared for the Conference “Central Asia and Europe: A New Economic Partnership in the 21<sup>st</sup> Century”. It considers how strengthened regional cooperation among SPECA member countries on the issues of trade, transport, energy and other areas of activities would lead to the improvement of the investment and business climate, and finally to the sustained economic growth and stability of the region. The document also considers the relations of SPECA member countries with the donor community and with the European Union in particular. Recommendations are made related to the improvement of technical assistance from the international community in the area of regional economic cooperation, particularly with regard to the United Nations and the European Union. Specific recommendations are made also on how to improve the investment climate, conditions for international trade and transport, as well as on cooperation possibilities in the power generation sector.

The transition to a market economy has deeply affected the economic development of SPECA member countries. The economic crisis of the 1990s led to a significant drop in income of the population and a leap in the poverty rate and the growth of inequality. These countries have faced the challenges of transition and tried to meet them independently while establishing the sovereignty of their states, and as a result regional cooperation issues have played a secondary role.

At the same time, despite their national character these challenges of economic growth and social development have a deep regional context because SPECA countries are intimately connected with one another. The economic and social development of the countries is affected by management issues of water and energy resources, migration of labour, intra-regional trade, the special situation due to the availability or the lack of availability of transport infrastructures, particularly in, but not limited to, the enclave areas. The prospects for prosperity depend significantly on enhanced cooperation among the Central Asian countries, among others in the priority areas of transport, trade and management of water/energy resources.

The SPECA countries have made political declarations that recognize the exceptional importance of regional cooperation. In multilateral and bilateral meetings heads of state have called for the integration of states. Numerous arrangements regulating regional cooperation issues have been concluded, although there is a wide gap between the documents adopted and their implementation.

Two significant studies have recently been conducted in the area of regional cooperation, the Central Asian Human Development Report of the United Nations Development Programme (UNDP) – “Future without Barriers: Regional Cooperation for Human Development and Security” – and the Asian Development Bank (ADB) report “Central Asia: Increasing Gains from Trade Through Regional Cooperation in Trade Policy, Transport, and Customs Transit”. Both reports confirm that if current barriers to trade, transport and transit were to be removed, per capita GDP of the Central Asian states could increase by 50-100 per cent in the next 10 to 20 years.

Some of the recommendations in these reports indicate that Central Asian countries could increase the benefits from their participation in external trade and decrease the related expenditures if they were to:

- Promote regional economic cooperation especially in trade and transit, water and energy management;
- Liberalize trade policy in a more coordinated manner; and
- Develop and carry out a time bound action plan in the above areas.

It is broadly believed that the international donor community could and should do more to support development in all these countries, as well as their endeavour to strengthen the integration of their economies. This support could take different forms, such as financial assistance or institutional support. It may be multilateral or bilateral. Support to regional cooperation in the area of trade, transport and energy is one of the key aspects for the future prosperity of the SPECA countries.

## ***I. COOPERATION OF CENTRAL ASIA WITH THE INTERNATIONAL DONOR COMMUNITY AND EUROPEAN UNION COUNTRIES***

The SPECA countries under consideration have relations with a large number of donors and other members of the international development community including countries, organizations, and development banks, among them the European Union, the United Nations and the CAREC group.

The level of donor participation in the region is determined by the political and economic conditions of the individual country. Different levels of economic development, mainly thanks to the different level of wealth in natural resources, have led to various levels of donor participation in these countries. For example, Kazakhstan and Azerbaijan are becoming donor countries in some of the international organizations.<sup>2</sup> In Kyrgyzstan and Tajikistan the participation of the donor community, especially international development banks, in the development area is significant. Notwithstanding the growing differences in the level of economic development among SPECA member countries, active international support to strengthening regional economic cooperation will remain an important precondition of sustained economic development and stability of the region as a whole.

Technical assistance to SPECA countries is delivered in accordance with globally accepted rules aimed at increasing the effectiveness of aid to countries that receive significant assistance from donors. Despite this fact due to the wide range of various donor requirements when preparing, implementing and monitoring projects and programmes and a lack of coordination among various donors, a great deal of resources was wasted both by donors and by recipients. To resolve these problems attempts are being made to reduce operational expenses and improve the effectiveness of donor assistance by harmonizing donor procedures at the global, regional and national levels.

A high level forum held in Rome in February 2003 on issues regarding harmonization and coordination with the aim of raising the effectiveness of foreign assistance, identified Kyrgyzstan as a pilot country. A Supervisory Board and a Working Group on harmonization were created in Kyrgyzstan. The experience of this country could be the basis for implementation of similar activities in other SPECA countries. At the same time regional projects should be coordinated. The mutual initiative of the SPECA countries could be a way to achieve this. As a first step, the commitment for regional cooperation could be emphasized by its inclusion in the national strategic documents, for example in the National Poverty Reduction Strategies.

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<sup>2</sup> Kazakhstan is a founding member of the Eurasian Development Bank, which has an initial capital of US\$ 1.5 billion, to be used mainly for development projects to be implemented in the EurAsEC framework. The Government of Azerbaijan has proposed establishing a SPECA training centre for e-governance in Baku.

## **1. The current state of Central Asian countries` cooperation with the EU**

“At the beginning of the 21<sup>st</sup> century the time has come for a new partnership between the European Union and Central Asian States in a globalized world.” This statement in the Report on the new Central Asia Strategy of the European Union, “A New Partnership Strategy”, made in May 2007 will be a key factor in developing relations between the EU and Central Asia.

In June 2007 the European Union adopted the Strategy according to which financial assistance to the region will double. Between 2007 and 2013 the amount of this assistance will reach 750 million euros. It is planned to activate negotiations between the EU and Central Asian countries on issues of energy and cooperation in the development of oil and gas deposits. The EU will give special attention to the issue of the region’s raw materials.

The Strategy is expected to help the EU and Central Asian countries to increase trade, investments, production cooperation and preparation of specialists. The EU delivers assistance in the area of poverty reduction, the fight against malnutrition and diseases, the eradication of human and drug trafficking.

All the Central Asian countries have signed EU Partnership and Cooperation Agreements whereby cooperation of the EU with separate countries is developed in such sectors as trade in goods and services, energy, transport, standards and evaluation of their compliance, agriculture and agro-industrial complex, customs and statistics.

The relations of the individual Central Asian countries and the EU have a different nature. For example, at present the relations of Kazakhstan and Azerbaijan with the EU are of a stable and long-term nature. Kazakhstan and Azerbaijan are the EU’s largest trading partners in the SPECA region. In particular, mutually beneficial relations in the areas of the oil and gas complex and other commodity sectors are developing more dynamically. In coming years Kazakhstan, Azerbaijan and Turkmenistan will become the largest suppliers of Caspian oil and gas resources to the European markets. Moreover, economic ties in the area of transport, industry and agriculture have been expanded.

Although the relations of Tajikistan and Kyrgyzstan with the EU cover many sectors and are developing rapidly, they have not yet moved out of the “donor-beneficiary” stage. Considerable mutual efforts are needed in order to exceed the bounds of simple assistance and pass to the qualitatively new level of mutually advantageous economic relations.

In recent times the relations between Uzbekistan and the EU have progressed beyond the cooling-off stage and become more intensive. EU investments to the country have increased although serious work is needed to increase trade between Uzbekistan and EU and strengthen investment relations.

## **2. Positive trends in cooperation between Central Asian countries and the EU**

### ***A. The creation of a legal basis for expanding trade and economic relations between Central Asian countries and the EU***

The Partnership and Cooperation Agreements between SPECA countries and the European Union define a legal framework for expanding trade and economic relations between SPECA countries and EU member countries. In particular the agreements specify conditions for carrying out business and attracting investment, as well as the cross border movement of services and revenue raised from investment, and measures to protect intellectual, industrial, commercial and property rights.

Bilateral cooperation bodies set up under these agreements, such as the Cooperation Councils at a ministerial level, have been holding regular meetings. With the aim of discussing topical issues of economic cooperation, as well as access to one another's markets for goods and services, the parties concerned set up Sub-committees on Trade and Investment, which were established, and are successful in the majority of the SPECA countries. These committees are also responsible for supervising transport and energy issues.

The implementation of the Partnership and Cooperation Agreements will assist economic development and reforms in Central Asia and create conditions for close relations with the EU in all spheres. In particular, they provide for most favoured nation treatment in trade between Central Asia and the EU and ban quantitative restrictions on imports.

In addition, the agreements encourage some countries' membership in the World Trade Organization (WTO), because many of their provisions on trade are based on WTO principles.

The countries of Central Asia have also signed bilateral agreements with many EU member countries. Their implementation will become an important factor in increasing the efficiency of cooperation with the EU.

### ***B. Expanding trade and economic cooperation between Central Asia and the EU***

The level of cooperation with the EU differs among the countries of Central Asia. All SPECA member countries have increased trade with the European Union. The total trade turnover between SPECA member countries and the EU increased from US\$ 5,7 billion in 2002 to US\$ 31,6 billion in 2006. As a result the share of the EU increased from 20.2 % to 31.6 % within the total foreign trade of the SPECA region. This increase is partially explained by the enlargement of the European Union. The share of new member countries within the overall trade turnover between the European Union and SPECA member countries was 5.2% in 2006. The effect of enlargement was different in the case of various SPECA member countries: for example the proportion of new member countries is a mere 2.6% and 3% in the trade of the EU with Azerbaijan and Kyrgyzstan while it is 5.6% and 11.5% in the case of Kazakhstan and Tajikistan.

Economically Kazakhstan and Azerbaijan are the largest trade and investment partners of the EU in the SPECA region, while the EU is in first place in the list of these countries' trade partners.

An analysis of trade of Kazakhstan and Azerbaijan with the EU makes it possible to detect a positive trend in the development of bilateral trade between these countries (Table 1).

**Table 1**  
**Trade between Central Asian countries and the EU**

Country	Year	Trade with EU US\$	Total trade of the country US\$	Trade share with EU %
<b>Azerbaijan</b>	2002	844.7	3832.9	22.0
	2006	5267.6	11639.8	45.3
<b>Kyrgyzstan</b>	2002	440.2	1072.3	41.1
	2006	1331.7	2512.3	53.0
<b>Kazakhstan</b>	2002	3083.9	16254.3	19.0
	2006	22790.1	61927.2	36.8
<b>Tajikistan</b>	2002	296.3	1458.0	20.3
	2006	877.1	2238.5	39.2
<b>Uzbekistan</b>	2002	1065.8	5700.4	18.7
	2006	1314.0	10785.7	12.2

*Source:* National statistical agencies.

EU member countries account for 36.8 per cent of Kazakhstan's total foreign trade. EU countries have invested over \$35 billion in the Kazakh economy, or 53 per cent of the total investment placed in Kazakhstan (\$67.7 billion).

The EU is interested in Kazakhstan and Azerbaijan because of its rich hydrocarbon reserves, consistent economic reforms and steady high economic growth of GDP over the past years.



We see a different picture in the area of trade relations between the EU and the Central Asian countries which do not export energy resources, for example, Kyrgyzstan and Tajikistan. The level of trade between these countries and the EU is not high. While trade relations between Tajikistan and EU countries have been developing rapidly over the last three years, the share of trade with the EU has constantly decreased. It is noticeable that Tajikistan has a positive trade balance with EU countries. At the same time Tajikistan exports to the EU consist mainly of cotton fibre and primary aluminium, which makes these trade relations vulnerable to fluctuations in commodity prices.

Relations between Kyrgyzstan and the EU have been developing dynamically. EU exports to Kyrgyzstan have increased by almost 4.5 times between 2002 and 2006, while imports have almost doubled. Despite the fact that Kyrgyzstan is in the 160<sup>th</sup> place among EU trade partners, these relations have a special character for Kyrgyzstan. It is the only state in the SPECA region where the share of the European market exceeds 50 per cent. But in contrast to Tajikistan, trade relations are less vulnerable to price fluctuations because of the wide variety of external trade goods.

The trade relations of Uzbekistan with the EU are developing relatively slowly. Although the total trade of Uzbekistan almost doubled between 2002 and 2006, the share of trade with EU countries decreased from 18.7% to 12.2%. The modest share of the EU in the overall trade of Uzbekistan obviously does not correspond to the real potential of these relations. Uzbekistan could become a considerable supplier of energy as well as agricultural products.

**Table 2**  
**SPECA countries: comparative structure of exports**

	Share of the three main products in overall exports
<b>Azerbaijan</b>	Oil and oil products (88.8) cotton (1.0) metals (1.0) Total: 90.8
<b>Kazakhstan</b>	Oil (50.6) iron and steel products (9.8) copper (7.1) Total: 67.5
<b>Kyrgyzstan</b>	Non-ferrous metals (51.7) electricity (9.8) machine-building (12.0) Total: 73.5
<b>Tajikistan</b>	Aluminium (61.0) cotton fibre (11.0) electricity (12.0) Total: 84.0
<b>Turkmenistan</b>	Gas (58.0) oil and oil products (14.0) cotton fibre (6.0) Total: 78.0
<b>Uzbekistan</b>	Cotton (24.4) gold (28.3) energy (11.8) Total: 64.5

*Source:* Trade development in the Commonwealth of Independent States, IMF Working Paper WP/03/207, 2003.

*Note:* Azerbaijan, Kazakhstan and Turkmenistan in year 2000, Kyrgyzstan, Tajikistan and Uzbekistan in year 2001.

Almost all Central Asian exports are of raw materials. This makes the exports to the EU unstable since price fluctuations can lead to a reduction in supply. One of the aims of the cooperation between SPECA countries and the EU should be assistance from European

countries in order to diversify production and exports and to undertake measures to increase the value added of export goods.

SPECA countries are eager to increase imports of high technology and modern equipment using different financing mechanisms such as credits, financial leasing, factoring, even barter and so on. In this regard there is a need to remove the contradiction between the low capacity of some SPECA countries to pay and the necessity to replace obsolete machinery.

There are some barriers to the improvement of economic relations between the EU and the SPECA region. There is a shortage of commercial information about local markets and the cooperation level on marketing issues is low. Trade volume depends on transport communications, and the great distance between the two regional markets, high transport tariffs, tariff and non-tariff barriers for transit, all restrain full-scale cooperation between the EU and SPECA countries.

An important sphere for Central Asia is the development of relations with the EU in the energy sphere. In this context promising spheres for developing cooperation are:

- under the TRACECA international transport project;
- under the INOGATE international programme to transport oil and gas to Europe;
- under multilateral agreements on transiting energy in accordance with the Energy Charter.

### *C. The expansion of the EU Troika-Central Asian dialogue*

The EU Troika-Central Asian dialogue is one of the instruments of interregional cooperation. The fourth meeting in this format was held at the level of Foreign Ministers in Astana on 28 March 2007. This meeting discussed the new draft EU Strategy for Central Asia in 2007-2013, which was adopted on 21 June 2007, and issues of the socio-economic development of Central Asian countries, among others trade between regional countries and fighting common threats and challenges; education and professional training in the countries of Central Asia; energy, and environmental protection. Issues raised in the meeting will become the basis for further regular dialogue in this format.

Participants highly appreciated the overall results of the meeting, its openness and constructiveness, and the exchange of views. EU officials said the meeting had shown the Central Asian partners' readiness for fully-fledged cooperation to implement the new strategy.

However, in addition to the positive trends in expanding trade and economic relations between Central Asia and the EU, there are some unresolved problems:

## **3. Some unresolved problems**

### *A. The absence of a common strategy for the diversification of trade and investment relations between EU member countries and Central Asia*

EU member countries and their Central Asian partners have no common strategy for the diversification of their trade and investment links.

For example, investments by EU countries are directed mainly to Kazakhstan's extractive sector with priority given to oil and gas.

In this connection, the development and adoption of a common strategy for the diversification of economic links between EU member countries and Central Asian countries could be considered. This strategy could define the priority areas in cooperation between these countries.

### ***B. The effect of measures adopted by the EU to protect the internal market***

The EU has in recent years introduced several measures (e.g. anti-dumping measures) for the protection of the internal market, which have occasionally affected exports from the SPECA region. For example, the EU has introduced quotas for importing steel, textiles, grain, meat and other farming produce from Kazakhstan. These issues are being addressed at the intergovernmental level.

In particular, in line with the European Commission's resolution of October 2002 and agreements reached later, eight Kazakh enterprises have been allowed to export fish products to EU countries since October 2004.

The Kazakh Government and the EU are currently preparing an agreement on the trade of certain steel products, which should replace a similar agreement signed in July 2005.

At the same time, the issues of lifting restrictions on mutual trade between Kazakhstan and the EU are being resolved slowly, and this is negatively affecting the expansion of trade and economic relations between them.

In the case of other Central Asian countries such as Uzbekistan, Tajikistan and Kyrgyzstan, these measures have not caused significant problems yet due to the relatively small amounts of exports.

### ***C. Improving conditions of transport between the region and the European Union***

The lack of coordination in tariff and customs policies among countries of the Commonwealth of Independent States (CIS) is a specific obstacle to the development of trade and economic relations between SPECA countries and the EU.

The Russian Federation is the largest transit country in the CIS, but its international transit railway tariffs, set by the Russian Transport Ministry, are higher than the tariffs in Central Asian countries, which reduces the competitiveness of Central Asian products supplied to EU markets.

A similar situation has emerged with energy transits. CIS countries have not yet drafted common approaches to setting tariffs for transiting oil and gas. For example, transit tariffs for

Kazakh exporters are higher than those for Russian oil companies. This leads to a decrease in the profitability of exports to European markets.

Issues of customs policy in the CIS have not been tackled either, and this is also hampering the efficient development of cooperation with the EU. The system of customs controls of energy exchange is not effective. The Eurasian Economic Community is planning a series of steps to establish a free trade area and later a customs union. If implemented, these steps would improve the competitiveness of Central Asian exports on the EU markets.

### ***Box 2. Problem of illegal payments***

One of the serious problems for trade development is illegal payment during transit of goods within and outside of the region. It especially harms landlocked countries. Depending on the route, these expenses reach 16 to 40 per cent of the cost of goods delivery. The next significant expense item is related to customs escorting and storage of goods, i.e. customs terminal services, as well as payment of customs fees <sup>3</sup> that in aggregate amount to 10 per cent of the cost of the goods. It should be noted that there is one more factor that creates barriers to trade, which as a rule is missed by many researchers. This relates to the restriction of competition and imperfect market mechanism in the given sector, thus, transport tariffs are overrated. According to the authors' evaluation, the exclusion of non-compulsory transport expenses will allow decreasing motor vehicle tariffs to be reduced by 46-70 per cent depending on their routes.

### **Conclusions**

An analysis of the state of economic cooperation between SPECA countries and the EU has made it possible to draw the following conclusions:

1. The further development of cooperation between SPECA countries and EU countries is a priority aspect of SPECA countries' foreign economic policy and an important factor in their sustainable economic development.
2. Creating a favourable investment climate and actively attracting European capital are significant factors in diversifying SPECA countries' economies and boosting their competitiveness.
3. Since strengthened regional economic cooperation would facilitate the effective solution of problems hindering the development of EU-Central Asian trade and investment relations, the integration experience of the EU, as the most successful and advanced integration union in the world, is useful for SPECA countries.
4. The development of a strategy for the diversification of trade and investment links between EU countries and SPECA countries is worth considering.

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<sup>3</sup> The authors of this study did not consider tax payments, which from the formal point of view do not have the character of barriers despite increasing the costs of trade transactions.

## ***II. POSITIVE TRENDS IN ECONOMIC COOPERATION AND INTEGRATION AMONG CENTRAL ASIAN COUNTRIES***

An analysis of the development of cooperation and integration processes in the Central Asian region has pointed out the following **positive trends in regional cooperation**:

### **1. Creation of a legal basis**

Treaties on eternal friendship, cooperation and mutual assistance have been concluded between Kazakhstan, Uzbekistan and Kyrgyzstan. These treaties will deepen integration between the Central Asian countries.

A number of agreements and accords have been signed at an intergovernmental level to speed up integration processes in the real sector of the economy, including:

- Agreement on Using Fuel and Energy and Water Resources, Constructing and Operating Gas Pipelines in the Central Asian Region;
- Agreement between the Governments of Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan on Using Water and Energy Resources of the Syrdarya River Basin;
- Agreement on the Parallel Work of the Power Systems of Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan.

The Programme to Cooperate in the Sphere of Migration and the Programme to Create Legal, Economic and Organizational Conditions for the Free Movement of Labour have also been adopted. These documents could potentially create a common labour market in the future.

An interstate coordination council at ministerial level was set up in 2006 to accelerate economic cooperation between Kazakhstan and Uzbekistan. The council met in Tashkent in July 2007 and discussed developing cooperation in the financial, energy, transport, agricultural and water sectors. Kazakhstan and Kyrgyzstan set up a similar council in 2007. This council will expand trade and economic ties between the two countries.

### **2. Bilateral trade and investment relations**

Bilateral meetings of Central Asian countries have been activated in recent times and have led to an improvement in cooperation issues. A policy to develop mutually beneficial relations with neighbouring countries is boosting cooperation between the countries in the investment sphere.

For example, during the official visit of the Kazakh President Nursultan Nazarbayev to Tajikistan (on 12-13 September 2007) the two sides discussed an agreement on setting up a Kazakh-Tajik investment fund with an equity capital worth \$100 million. This will without doubt become an important factor in expanding integration between the two countries. The priority sectors of the Tajik economy are hydropower engineering and the aluminium

industry. The involvement of Kazakh capital in these sectors will help to develop them efficiently, stabilize the situation in the real sector of the Tajik economy and create new jobs.

During a visit to Uzbekistan in July 2007, Kazakh Prime Minister Karim Masimov discussed developing investment cooperation between the two countries. In particular, he made a presentation there on the work of the Development Bank of Kazakhstan, pointing to the Kazakh side's readiness to invest in joint breakthrough projects in the energy and other sectors of the economy. These projects will become an important factor in the sustainable development of the two countries.

Kazakhstan is also stepping up cooperation with Kyrgyzstan in the investment sphere. During President Nursultan Nazarbayev's visit to this country, the two sides discussed a number of projects in the real sector of the economy. Creating a hydropower engineering joint venture, with the involvement of state-owned companies from Kazakhstan, Kyrgyzstan and the Russian Federation, is important for Kyrgyzstan's current development. The new enterprise is expected to complete the construction of two hydropower stations on the Naryn River – the Kambarata-1 and Kambarata-2 stations.

During the visit, the Kazakh leader also stressed the necessity to tackle problems relating to Kyrgyzstan's economic development and to stabilize the situation regarding social issues. It should be noted that Kazakh investment in the Kyrgyz economy exceeded \$300m in 2006, or 30 per cent of foreign direct investment in the country.

Investment cooperation has thus been rapidly activated within the region. As a result, Central Asian countries are now intensively boosting economic cooperation with other Central Asian countries, which meets the interests of the whole region. All Central Asian countries are interested in the stable development of the region as a whole since this is an important factor in strengthening regional security and maintaining stable economic growth in all countries of the region. An unstable economic situation in any Central Asian country may become a breeding ground for the spread of terrorism and extremism in the region. All these problems should be solved through cooperation and integration among Central Asian countries, implementing joint projects in the real sector of the economy, boosting the competitiveness of their industry and improving the living standards of their population. Solving these problems will make it possible to counter existing threats in the region and to ensure the sustainable development of the countries.

On the other hand, despite some positive trends in regional cooperation between Central Asian countries in general, there is some slowdown in the pace of the integration processes in Central Asia. One can say that the relations between SPECA countries stay at the level of cooperation on most issues and have not come to the stage where they could be characterized as integration relations. In view of this, donors should combine their regional programmes with bilateral and trans-border projects: in many cases, when large-scale regional cooperation initiatives are not yet possible, support for bilateral and trans-boundary cooperation between Central Asian countries and their relevant boundary communities can pave the way for larger, regional programmes later.

**Conclusions**

Despite progress in the creation of a legal basis for regional cooperation and repeated expressions of political will to improve such cooperation, implementation of decisions is progressing slowly. Lack of mechanisms to enforce decisions when they are adopted is a main factor slowing down the development of regional economic cooperation.

### ***III. SECTORAL PROBLEMS OF ECONOMIC COOPERATION IN THE REGION***

These problems are most visible in the sectors under consideration.

#### **1. Water and energy**

Efficient use of water and energy resources in Central Asian countries remains a problem. In line with the Agreement on Using Water and Energy Resources of the Syrdarya River Basin, the riparian countries annually sign intergovernmental agreements under which Kazakhstan and Uzbekistan assume obligations to guarantee coal, fuel oil and gas supplies to Kyrgyzstan, while Kyrgyzstan has to provide these countries with water during the growing period. However, this agreement is often violated.

#### ***Box 3. Relations between upstream and downstream countries***

Upstream countries suffer from a shortage of oil products and gas, which are delivered mainly from other countries of Central Asia. In the past breakdowns in the delivery of these products have negatively affected the economic development of upstream countries. In turn, the upstream countries – under serious pressure to meet domestic energy demands – have often departed from agreed water regimes, which has led to floods in downstream countries and forced the construction of additional dams. A solution to this problem is possible only through the strengthening of market-based mechanisms for energy deliveries - possibly in the form of a regional water-energy consortium - and intensive training of government officials and experts in cooperative water management to enable them to work out and implement solutions in accordance with relevant international legal instruments, norms and recommendations.

In addition, in the water sector, there are continuing problems due to occasional violations of the agreed limits of water diversion from the Syrdarya River and because of water pollution. The issue of ensuring water for Kazakhstan's southern regions remains an important problem which requires the elaboration of mutually agreed cooperative solutions with Uzbekistan regarding the coordinated management of water resources. A similar problem exists between Kyrgyzstan and Uzbekistan with regard to the resources of the Naryn River water reservoirs.

In 1998 the Central Asian Economic Community proposed a project to establish an International Water and Energy Consortium to improve the mechanisms of water and energy utilization. However it is still at the discussion stage and there are no signs of its implementation.

Within the Eurasian Economic Community (which incorporated the Central Asian Economic Community in 2005), a draft blueprint on the efficient use of water and energy resources in the Central Asian region is currently being drafted and coordinated.<sup>4</sup>

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<sup>4</sup> The concept is based on the Strategy on the rational and efficient use of water and energy resources in Central Asia, which has been worked out in the SPECA framework.



In the energy sphere, the poor level of coordination in pursuing customs, tax and tariff policies in Central Asian countries remains the main problem.

For example, the inefficient system of customs controls over energy resources is a serious problem. The existing rules for customs controls over electricity flows between countries do not help the countries' power systems to function efficiently in a parallel regime.

In the field of tax policy, different norms are practised by different national legislations. For instance, in Kazakhstan, in contrast to other Central Asian countries, electricity is an excisable good, and this leads to certain legal collisions, which do not help the countries' power systems to function efficiently in a parallel regime.

In tariff policy, there are no common approaches to setting tariffs for transiting energy. This lack of a single tariff methodology to some extent restrains the development of the countries' transit potential.

An element of constraint in expanding integration between Central Asian countries in the energy sphere is the poor development of the oil and gas-transporting infrastructure. In Kazakhstan, for instance, many major gas fields, including in the Tengiz, Zhanazhol and Uritau fields, do not have access to export pipelines. The export capacities of Uzbekistan – which is a major corridor to transit gas from Turkmenistan to Russia and a major gas supplier to Kazakhstan, Kyrgyzstan, Russia and Tajikistan – are limited to the only gas pipeline from Central Asia to central Russia and other CIS countries.

## **2. Trade**

Trade and economic relations between these countries are limited mainly to energy supplies and transit of goods. The share of industrial goods and foodstuffs is insignificant in regional trade. For example, on average other Central Asian countries each account for 0.6 per cent of Kazakhstan's foreign trade, which means that the potential of regional trade has not been fully tapped. In 2006, Kyrgyzstan accounted for 0.7 per cent of Kazakhstan's foreign trade, Tajikistan 0.3 per cent, Uzbekistan 1.1 per cent and Turkmenistan 0.2 per cent.

Despite a growing positive trend in trade and economic relations between Central Asian countries (Table 3), the economic potential of Central Asian states could bring mutual trade to a higher level.

**Table 3**  
**Trade within Central Asian countries**

Country	Years	Million US\$		Share of SPECA countries
		Trade with SPECA	Total Foreign Trade	
Azerbaijan	2002	196.8	3832.9	5.1
	2006	405.9	11639.8	3.5
Kyrgyzstan	2002	262.4	1072.3	24.5
	2006	482.0	2512.3	19.2
Kazakhstan	2002	376.9	16254.3	2.3
	2006	1295.6	61297.0	2.1
Tajikistan	2002	289.9	1458.0	19.9
	2006	497.8	2238.5	22.2
Uzbekistan	2002	491.8	8,5700.4	8.6
	2006	1015.9	10785.7	9.4

*Source:* National statistical agencies.

With Uzbekistan joining the Eurasian Economic Community, opportunities to expand integration and trade and economic ties between the member countries, including the Central Asian countries, have increased.

This membership requires Uzbekistan to bring its national legislation in line with the legislative requirements of the community, making it possible to forecast that this country will open up its domestic market, create a favourable investment climate and carry out a coordinated customs policy in the future. Solving these problems will become an important factor in developing trade among Central Asian countries.

### 3. Transport

There are continuing problems around the efficient use of the Central Asian states' transport and transit potential. Under-developed transport infrastructure poses one of the most serious problems. In comparison with countries with similar GDP/capita ratio, the region could be considered as one that is served by a relatively extensive rail and road system. In fact however, the transport infrastructure network has way too many missing links and gaps both in inter-connections and in the internal integration of the countries themselves. An even more serious concern is the lack of capacity to maintain its already existing infrastructure. The maintenance backlogs are formidably huge.

Central Asian countries ratified/joined a number of international conventions, several of the UNECE legal instruments that facilitate the free flow of people and goods. Some of them - Uzbekistan and Kyrgyzstan - ratified all recommended agreements. However, one of the most serious problems is non-implementation of ratified agreements and their collision with national laws. According to some experts' views the Minsk Agreement of 1999 on weights

and dimensions of vehicles has different provisions and limits than the UN Multinational agreements.

The Central Asian countries serve each other as a transit country in international trade. Consequently, the Central Asian regional integration and the further growth of regional trade directly connected with the state of regional and intraregional transport sector. The land-locked nature of Central Asia make the land transports the main means of its trade with neighbours and the outside world.

Even domestic trade between certain parts of the Central Asian countries involves transit through one or other Central Asian country. The shortest route connecting two parts of the same country often passes through a neighbouring country. Accordingly, the transit system in the Central Asian countries has significant effects on both intra and extraregional trade in Central Asia.

One of the most overwhelming problems is the inefficient border crossing procedures, which often include lengthy and costly physical inspection of cargoes at the border. One of the reasons for this is the lack of bilateral arrangements between certain States in the region. For example, Uzbekistan and Tajikistan do not have either a road transport agreement or a rail transport agreement and Afghanistan has had no transport arrangements with other Central Asian States. The main objectives of the bilateral arrangements are to provide for market access (in case of road transport in terms of quotas or in case of a liberal road transport regime, the conditions for liberal access to markets). As a rule, they also include technical provisions such as limitations on weights and dimensions. The national harmonization with the international agreements, however, requires more than diplomatic, policy or regulatory actions. The very first task is to rebuild the road infrastructure to be able to carry the traffic by trucks with higher gross weight or axle load. Speaking about weight regulations in the road transport sector, it also needs to be borne in mind that countries that lack a national rail network, like Kyrgyzstan, but have industries that require heavy goods vehicles to transport truly heavy cargo, have a very special situation indeed.

With regard to the facilitation of international trade, we should recognize that all Central Asian States are signatories to the TIR agreement and participate in the international transit system based on the Customs Convention on the International Transport of Goods under Cover TIR Carnets. TIR is a key instrument in facilitating international transit traffic. In relative figures, Central Asia is the fastest growing TIR region: over the last 5 years, the annual number of TIR Carnets issued here has increased by 450% and reached 55,000. In particular, the road transport industries of Kazakhstan and Kyrgyzstan have shown remarkable growth, due to the transportation of Chinese goods from the Chinese border to third countries.

At the same time, several factors impede further development of the TIR system:

- More often than not, the Customs authorities of Central Asian countries do not properly implement the TIR Convention. In particular, they apply excessive controls (examination, escorts, etc.) that undermine facilities provided for in the Convention.

Risk management techniques are practically unavailable. This problem is further deteriorated by illicit drug trafficking from Afghanistan;

- The TIR Convention addresses only one, though important, aspect of border crossing – Customs transit. Apart from Customs, numerous requirements imposed by other control authorities should also be met before a truck can continue its journey through the border. The still unresolved problems of bilateral road transport permits are also worth mentioning;
- There is a big share of small-size transport companies owning from 1 to 3 road vehicles. Sometimes, they have difficulties in meeting the reliability and security criteria set out by the TIR Convention;
- Typical goods exported from Central Asian countries (oil, gas, cotton, other raw materials) are normally transported by rail or by pipelines. Road transport is mainly used for import and transit goods. For haulage of such goods, transport operators of the country of exportation are hired in most cases. For this reason, haulers from countries that export goods to Central Asia (Turkey, Iran) are the most competitive on the TIR market in Central Asia.

It also needs to be considered, that the national road transport industries in the Central Asian countries need to become more competitive. The current legal environment and government practices, however, do not support the growth and strengthening of the domestic transport industries. Several different measures should be taken therefore to enable this services sector to compete internationally, e.g. waiving Customs duties and taxes on import of vehicles, more favourable conditions for leasing, a streamlined system for the registration of new fleet, overall reduction of the tax burden for newly established transport companies in the initial period, etc.

The Central Asian countries are trying to establish a new regional transit system. To this end the Central Asian countries signed different agreements and declarations with the support of a number of regional organizations (the CIS, ECO, and EURASEC). So far, these attempts have had rather limited effect on customs transit in Central Asia. Some of these agreements have not yet entered into force, even ratified agreements are not being implemented, and some of them do not address issues relating to the provisions of a guarantee for customs transit and so on. Many elements of the system (transport inspections and organizations that could serve as national guaranteeing bodies) are already present in Central Asia.

There are, however, a couple of critical questions to be raised here:

- the current issues with regard to transit are primarily due to the slow progress of the reforms of the customs and other related agencies;
- the costs of TIR are likely to be very low in comparison with the costs of the set-up of a new transit guarantee system. Therefore, the efforts spent on working out a new system are likely to divert the political attention to the need for reforms and to postpone them, as they are being politically sensitive and difficult to embark on. At the same time, it needs to be recognized that intra-regional traffic may require a somewhat different and even less-costly solution. The question, if this is possible within the TIR system itself or in bilateral or pluri-lateral framework, still needs to be investigated.

Within the Eurasian Economic Community, a draft blueprint to set up a single transport space, comprising the member countries, is being prepared and coordinated.

#### 4. Investment

It is worth pointing to the poor level of development of intraregional investment cooperation.

For example, enterprises with the involvement of Kazakh capital account for only 1.5 per cent in Uzbekistan (some 50 enterprises). The number of Kazakh enterprises is higher in Kyrgyzstan but a significant drop in investment activity took place following the political turmoil in the first half of 2005. Intraregional investment is well below the potential and real needs of Tajikistan. Kazakh investment in the economies of neighbouring countries is presented in Table 4.

**Table 4**  
**Kazakh investment in Central Asian economies in 2006 (million US\$)**

	Kyrgyzstan	Uzbekistan	Tajikistan	Turkmenistan
Kazakhstan	309.2	152.3	94.0	5.8

*Source:* Kazakh National Bank

An analysis of these data allows us to gauge the untapped potential of investment cooperation between the Central Asian countries. For comparison, according to the Kazakh National Bank, in 2006 Kazakhstan invested \$4,590.1 million in the Russian Federation, \$2,082.9 million in the United Kingdom and \$1,122.5 million in the Netherlands.

#### ***Box 4. Foreign direct investments can improve trade cooperation***

The following case supports this: Before 2000 Kyrgyz enterprises faced barriers when exporting dairy goods to Kazakhstan. This problem was solved only after large Kazakh investments in the banking sector of Kyrgyzstan. These investments provided the necessary credit to dairy exporters who were seeking a market for their goods in Kazakhstan.

Policies aimed at further development of beneficial investment relations would intensify investment cooperation. It is expected that the accession of Uzbekistan to EURASEC will lead to an increase in intraregional investments.

## 5. Agriculture

In the agricultural sector there is also a lack of coordination between the countries in pursuing a common policy. In particular, instead of promoting the production of crops for which local climatic and other conditions are the most suitable, there have been efforts to achieve self-sufficiency in grain production instead of importing grain from other Central Asian countries. Central Asian countries should adopt a more coordinated approach to developing the agricultural sector, specifying the regional division of labour and defining agricultural specializations.

### *Box 5. Economic losses resulting from the low cooperation level in the agrarian sector: case of Tajikistan*

Tajikistan is interested in the creation of a free trade regime in the region. It is especially important for agricultural producers. Before the collapse of the Soviet Union the rural population of Tajikistan had the right to sell agrarian products anywhere in the Soviet Union. The main part of this production was sold in the oriental markets of Central Asia. In Turkmenistan a considerable share of the market in dried fruits, seed fruits, potatoes and carrots was taken by Tajiks. In Uzbekistan a niche related to vegetables (tomatoes, carrots, potatoes), dried fruits and fresh apples and pears was filled by the products from Tajikistan. Tajikistan peasants provided the markets of Kyrgyzstan with dried fruits and citruses, and Kazakhstan with early cabbage, early potatoes, fresh grapes, citruses and dried fruits.

The people of the Sogdiy valley received an income from the sale of their farmlands' products in the Tashkent, Syrdarya and Djizak oblasts. Such an income could not be received from the sale of production within the narrow bounds of their own oblast market. They still cannot sell their products in the central and southern regions of Tajikistan due to transport problems in hard-to-reach mountain ranges because of the bad roads. The free sale of production in Uzbekistan and other countries of the region have created big incentives for the effective maintenance of the agricultural sector. According to estimations, the sale of agricultural produce alone to the other republics of the Soviet Union generated an income for the rural populations of about US\$ 1.8-2.5 billion.

After the establishment of new borders following the collapse of the Soviet Union and the failure of successor countries to establish a simplified regime of border crossing for the populations living along these borders, the agricultural sector of the Sogdiy oblast declined sharply, and in order to provide for their families the male population joined the external labour migration and left the region.

## 6. Problems of regional labour market

Socio-economic problems in the region are encouraging migration from other countries to Kazakhstan and also neighbouring countries like Russia. Regional cooperation in the management of labour migration, including the harmonization of relevant laws, a regional system of social security for migrant workers, establishing conditions for the safe and easy transfer of remittances, etc., are necessary to reduce the negative side-effects of unregulated or illegal labour migration.

Development of regional labour market has also a gender dimension. Women face gender specific barriers in access to employment, financing and information particularly in rural areas. Eliminating these barriers will help to reduce unemployment and poverty.

Countries have already some experience in supporting women's self-employment through micro credit schemes and trainings. Exchange of good practices and establishing gender-sensitive policies will have a positive impact on mobilizing women's economic potential for growth and development of regional labour market.

### ***Box 6. Economic losses resulting from the lack of gender perspective in economic policies of Central Asian and other countries***

Gender inequality reflected in the restrictions of opportunities and participation, is widespread in many parts of the world. This translates into deterioration of women's position in the labour market (including opening up of wage gap) and feminization of poverty. In Central Asia wage gap varies from 33 (Kyrgyzstan) to over 50 per cent (Tajikistan).

The untapped women's potential could lead to concrete losses to economies. The ESCAP estimates show that the ESCAP region is losing US\$ 42-47 billion annually due to restrictions on women's access to employment alone.

## **Conclusions**

This analysis of the integration processes that are taking place in Central Asia shows a positive trend in the development of economic cooperation between the regional countries. Bilateral ties are becoming active and bilateral trade is growing in the region. The development of investment cooperation in the region will become an important factor in the sustainable development of Central Asian countries in the future and in strengthening their economic security. In particular, a significant expansion of joint projects in the energy, transport, financial and other sectors would be feasible and beneficial for all Central Asian countries.

However, some serious problems in developing cooperation and integration processes in the region should be taken into account. A major restraint in expanding trade and economic relations between Central Asian countries is the low level of enforcement of decisions once they have been adopted. Other quite serious problems relate to the efficient use of energy and water resources in Central Asian countries, the state of transport infrastructure and management, as well as restrictions on the free movement of goods, capital, labour and services.

In this connection, high-level initiatives like Kazakhstan's initiative to create a Union of Central Asian States and the initiative of Uzbekistan to create a Central Asian Common Market seem to be very topical. Progress in these directions should help to form a single economic space and ensure the sustainable development of the countries of the region in the future.



#### ***IV. RECOMMENDATION ON STEPS TO IMPROVE ECONOMIC COOPERATION AND INTEGRATION AMONG CENTRAL ASIAN COUNTRIES***

Strengthening economic cooperation and integration among the Central Asian countries requires the following steps:

##### **1. Water and energy**

In expanding integration between Central Asian countries in the energy sphere, it is necessary to set up a common energy resources market.

The priority aspects of energy cooperation between Central Asian countries are the following:

###### ***A. Developing a regional energy market of Central Asian countries Expanding export capacities to supply to third countries***

Their implementation envisages:

- The joint development of a common regional fuel and energy policy by the relevant bodies in the different countries. This regional policy could be based on the assessed demand for energy and the production of energy resources, potential exports and transit. It could help to conduct a coordinated transit and export policy for the supply of energy resources to the internal and external markets. In this connection, the governments should draft and adopt a relevant agreement to develop and implement a common regional fuel and energy policy;
- Developing an optimal scheme to transport energy resources within the region, creating new transport systems and reconstructing existing ones to increase the energy exports of the regional countries.

###### ***B. Drafting coordinated principles for tariff, tax and customs policies in the energy sphere in Central Asian countries***

In tariff policy, it is feasible to:

- Develop common methodological approaches to setting tariffs for energy transits (power, oil and gas) and to adopt relevant agreements;
- Optimize railway tariffs to transport coal within Central Asian countries and beyond, and adopt a relevant agreement to define common approaches to drafting a tariff policy.

In tax policy, it is feasible to:

- Adopt measures to simplify the existing tax system in the energy sphere and improve its flexibility and adaptability; and

- Unify a list of excisable goods.

In customs policy, it is necessary to draft relevant legislative documents to simplify customs procedures for supplying energy resources within Central Asian countries and to third countries.

### ***C. Improving a technological basis for creating a common electricity power market***

In the area of creating a common power market, it is necessary to:

- Ensure the functioning of the power systems of Central Asian countries in a parallel regime;
- Create new power capacities to ensure the power security of Central Asian countries and cover their needs in cheap power; and
- Reconstruct and re-equip power engineering enterprises.

In the area of creating a common oil and gas market, it is necessary to:

- Increase the level of processing of oil and create new joint oil refineries;
- Develop underground gas storages to increase the reliability and flexibility of gas supplies; and
- Reconstruct and re-equip oil and gas enterprises and main pipelines; create new capacities and adopt new technology; fulfil projects to build Caspian and trans-Caspian gas pipelines and a pipeline from Central Asia to China.

In the area of creating a common coal market, it is necessary to:

- Increase the quality of coal and develop coal enrichment; and
- Reconstruct and re-equip coal enterprises.

### ***D. Establishment of a regional water and power consortium***

To this end, it is feasible to draft a concept for the creation of an international water and power consortium, which should define the task of developing a common system for the management of energy systems and water resources in the region. The purpose should be to assess the various countries' demand for energy and water and their ability to meet the demand. It should adopt a coordinated approach to preventing flood threats in border areas, conduct joint bank-enforcement measures, take steps to improve the quality of water and solve environmental problems.

In the water and power resources sphere, it is necessary to establish conditions for the safe and free export of electricity abroad (including to the Russian Federation, Afghanistan and China) from Kyrgyzstan and Tajikistan. In addition the water regime on the Naryn-Syrdarya cascade of reservoirs and Kyrgyzstan's responsibility to respect its obligations should be clearly defined.

The implementation of a blueprint for creating a water and power consortium will help the regional countries to pursue a coordinated policy to manage water resources and create a common complementary fuel and energy system among Central Asian countries. It might be useful to conduct a Regional Water and Power Summit to launch an initiative on a regional consortium.

In particular, the creation of a Water Academy should be considered. It could play an important capacity-building role by training government officials, experts and researchers in this area in order to facilitate their joint work at the regional level on key issues of water management and the elaboration of cooperative solutions in accordance with relevant international legal instruments, norms and recommendations.

### ***Box 7. Efficient use of water and energy resources***

Required technical cooperation assistance:

- Capacity-building concerning the implementation of the “Strategy for the Efficient Use of Water and Energy Resources in Central Asia”;
- Assistance to the elaboration of the principles of a coordinated SPECA energy market with an overall objective of enhancing economic growth through energy trade;
- Transboundary power exchange in the SPECA region;
- Elaboration of principles and mechanisms for the establishment of a water-energy consortium;
- Assistance to the elaboration of further projects under the Baku Initiative on Energy Efficiency and Conservation;
- Continuation of the project on dam safety in Central Asia;
- Continuation of the project “Development of Cooperation on the Chu and Talas Rivers”, dissemination of best practices at the regional level.

## **2. Trade**

The solution of the following problems is of great importance:

- Harmonizing customs legislations between Central Asian countries and mechanisms for tariff and non-tariff regulations of trade;
- Observing free-trade principles;
- Abolishing customs duties, taxes and levies, as well as quantitative and other restrictions on mutual trade; and
- The relevant intergovernmental agreements should be adopted to solve these problems.

***Box 8. Free trade regime and trade facilitation among Central Asian countries***

Required technical cooperation assistance:

- Capacity-building to improve administrative efficiency, simplification, standardization and harmonization of trade procedures;
- Enhancing the transparency of laws, regulations and procedures and information sharing on these and other trade facilitation issues;
- Assistance to the implementation and harmonization of free trade agreements;
- Assistance to WTO negotiators on trade facilitation;
- Networking of trade research institutions;
- Assistance to the implementation of Trade Facilitation Recommendations of UNECE and the United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT);
- Assistance to the setting up of national trade and transport facilitating bodies;
- Capacity-building in support of trade integration with an emphasis on integrated trade information flow management and trade facilitation;
- Assistance to enhancing trade competitiveness.

**3. Transport and border crossing**

Priority should be given to the maintenance of existing infrastructure. Investment planning should be part of the national Poverty Reduction Strategy Papers (PRSP) and Midterm Investment Programming; the UNECE-UNESCAP supported cooperation on the identification of the main investment projects for the Euro-Asian Transport Linkages should be taken into account also in the national planning.

In some Central Asian countries progress has already been made towards the application of modern infrastructure pricing. Sharing this experience and best practices should be an important element of capacity-building.

There is a need for sector reforms in all modes of transport – in this respect Kazakhstan has been pioneering rail reforms, and Kyrgyzstan has made huge progress in modernizing its urban transport policy, institutions and market structure. Sharing their experience at the regional level could become a catalyst of reforms in other Central Asian countries.

Since road safety is below the ECE region's average, technical cooperation assistance should be stepped up in this area.

The development of transport corridors requires the Central Asian countries to:

- Pursue coordinated customs, tax and tariff policies in the transport sector;
- Adopt joint measures to modernize transport infrastructure; and
- Undertake coordinated actions to attract financial institutions to modernize existing infrastructure facilities and build new facilities.

**Box 9. Infrastructure development through public-private partnerships**

Required technical cooperation assistance:

- Increase the expertise of SPECA governments to identify, negotiate, manage and implement successful public-private partnership projects (PPP);
- Explore international best practice in PPP (sectors, models, financing methods, etc.) with a view to identifying how the SPECA region can best use such models;
- Examine the main areas where PPP could be used to meet the infrastructure challenge and what governments need to do to attract private investors to PPP projects;
- Support to the establishment of a SPECA network of experts on public-private partnership;
- Assistance to the establishment of an enabling legislative environment for public-private partnerships;
- Capacity-building for and exchange of best practices in PPP among government officials and experts of SPECA member countries; and
- Include matters related to PPP in the work of relevant SPECA working groups and give consideration to setting up a working group dealing with public-private partnerships.

A blueprint for creating an international transport consortium could define measures to develop railway and motor routes, the more effective use of transport potential of Central Asian countries through better policies and better management of the transport system, and to consider the possibility of the construction of vehicles. Such a blueprint should aim at resolving the following problems:

**In customs policy**, the important issues are:

- Adopting measures to simplify customs procedures and customs control on borders between Central Asian countries and ensure the unhindered movement of goods between these countries and transit through their territories;
- Implementing the principle of “two sides of the border – one stop”;
- Adopting new technology for exporting and importing goods (paperless waybills, common forms of goods transport documents); and
- Creating a single computerized information system for Central Asian customs services.

**In tax policy**, it is expedient to draft a flexible system to tax transport enterprises in countries of the region and to reduce tariffs for all means of transport.

**In tariff policy**, it is important to take steps to bring domestic and international railway tariffs to a similar level. The difference in these tariffs complicates the development of international freight and increases transport costs in the final price of products.

In the future, the Central Asian region should adopt a single tariff policy and take measures to unify and harmonize transport legislation and create relevant legal conditions.

To achieve successful technical assistance in the Central Asian transport sector the following measures are considered important:

- Organization and facilitation of consultations on the conclusion of bilateral and regional agreements and setting up mechanisms for their monitoring and implementation;
- Assistance to the Central Asian countries on harmonization and coordination of regional transport projects and national transport strategies, and better organization of institutional mechanisms of transport relations;
- Further strengthening and broadening cooperation within SPECA in order to enlarge the scope of activity in the region;
- Take into account the Central Asian countries' concerns over insufficient funding and the necessity to provide sufficient financial resources for implementation of the SPECA initiatives, encourage more active involvement of state-donors and international financial institutions regarding participating in implementation of the SPECA efforts in Central Asia, and enhance the support of SPECA by major regional organizations such as the EU; and
- In the interests of the Central Asian region, take further measures on coordination of transport projects, unifying and harmonization of transport regimes between SPECA, Shanghai Cooperation Organization (SCO) and EURASEC.

#### ***Box: 10. Transport and Border-Crossing***

Required technical cooperation assistance:

- Comparative analysis and harmonization/unification of the maps of Central Asian transport corridors elaborated by various organizations (UNECE/UNESCAP, CAREC, TRASECA (Transport Corridor Europe-Caucasus-Central Asia), EURASEC, SCO);
- Establishment and maintenance of Central Asian/SPECA transport databases;
- Preparation of a guide on road wayside facilities;
- Identification and isolation of major bottlenecks impeding smooth and efficient international transport in Central Asia;
- Assistance to the establishment or strengthening of national facilitation coordinating mechanisms for improved collaboration between all stakeholders involved in international transport from the public and private sectors;
- Enhancement of legal frameworks for international transport to reflect suitable legal regimes for international land transport facilitation;
- Assistance to the accession to multilateral agreements on infrastructure;
- Promotion of demonstration runs of container block-trains and international train services;
- Simplification and harmonization of border-crossing procedures and documentation for international transport;
- Support to the application of new technologies, including information and communication technology;
- Capacity-building in the area of awareness of road safety issues;
- Establishment of intermodal transport corridors to and from SPECA countries.

#### **4. Harmonizing economic policies of Central Asian countries relevant for regional cooperation**

The adoption of the following measures seems to be feasible in order to harmonize the macroeconomic policies of the regional countries:

- Expanding cooperation in the financial and foreign exchange spheres; and
- Harmonizing tax legislation.

In order to achieve this objective, we believe it is necessary to draft a programme of harmonization of policies of Central Asian countries pertaining to regional economic cooperation. In the sphere of expanding cooperation between the countries in the financial and foreign exchange spheres, it is necessary to take measures to ensure the freedom of capital flows in the Central Asian region and to create a common financial market in the future.

In order to ensure the free movement of capital it is a priority to harmonize national legislation in the sphere of foreign exchange regulation and the full liberalization of currency transactions in the region.

Developing integration between the countries of the region in the financial sector requires measures to harmonize banking and insurance legislation and statutory documents on creating securities markets and creating favourable conditions for cooperation between entities through setting up joint enterprises and financial-industrial groups.

For these purposes, it is necessary to draft and adopt a number of intergovernmental agreements:

- Steps to harmonize Central Asian financial legislation;
- An agreement on setting up a common market for banking services;
- An agreement on setting up a common market for insurance services;
- An agreement on cooperation between Central Asian countries on securities markets.

In the area of harmonizing tax legislation, it is important to solve the following problems:

- Coordinating the main aspects of tax policy in Central Asian countries;
- Unifying the provisions of agreements on the avoidance of double taxation and the evasion of profit and capital taxes;
- Improving the taxation system for small and medium-sized businesses and creating favourable conditions for developing intersectoral relations in Central Asia, expanding production capacities and boosting business activity in the Central Asian economy.

***Box 11. Supporting regional cooperation and economic reforms in SPECA member countries with economic research***

Required technical cooperation assistance:

- In order to achieve continuity in the development in the different spheres of activities outlined in this paper, investments in capacity-building of official statistics are of great importance. Statistics should be perceived as infrastructure. Reliable statistical information is an indispensable part of monitoring progress and development;
- Enhancing the quality of regional cooperation and supporting the harmonization of the economic reform processes in the SPECA region by supporting economic research in key areas;
- Facilitating policy-research dialogue, enhancing the capacity of government officials, supporting evidence-based decision-making;
- Supporting the elaboration of new solutions and best practices to regional challenges;
- Facilitating research/private sector dialogue with a view to supporting applied economic research in areas of key importance for regional companies and the improvement of the regional business and investment climate;
- Facilitating policy-oriented research and exchange of good practices in inclusion of gender perspective into economic policies (in particular SME and tax policies, gender budgets, etc).

## **5. Increasing the competitiveness of Central Asian economies**

The following aspects have priority:

- Central Asian countries' pursuance of a coordinated innovative development policy; and
- Efficient development of the countries' scientific and technical potential.

In boosting investment and innovation activities, it is necessary to take joint steps to adopt modern technology, develop production with high added value, diversify export potential, create a favourable investment climate and attract foreign capital. In order to implement these tasks it is necessary to draft and adopt an interstate strategy for the innovative development of Central Asian countries and a plan of action to implement it. It is important to create control mechanisms for the application of these documents.

In the area of efficient development of the scientific and technical potential of Central Asian countries, it is feasible to:

- define the priority aspects of science and technology in Central Asian countries;
- adopt steps to develop modern industrial technology (above all, to process hydrocarbons and minerals and employ unconventional renewable energy sources);
- create modern telecommunications systems and adopt information technology in all sectors of the economy;
- build a global environmental and natural resources monitoring system in Central Asian countries.



It is timely to develop and adopt an interstate programme for the scientific and technical development of Central Asian countries and a plan of action to implement it.

Fulfilment of this programme and the plan of action require the involvement of the international development community, including the European Union.

***Box 12. Support to innovation and competition at the regional level, as well as protection and commercialization of intellectual property rights***

Required technical cooperation assistance:

- Capacity-building in order to create a supporting environment for innovative development and knowledge-based competitiveness of SPECA member countries through regional cooperation in relevant areas;
- Support to the establishment of a regional network for knowledge-sharing, exchange of experiences gained and lessons learned;
- Identification of best practices leading to the formulation of better policies;
- Assistance to the creation of a supportive environment – including the elaboration of relevant model laws – for innovative development in the SPECA region;
- Capacity-building with the objective of building up local innovation systems to help commercialize intellectual property and improve the investment environment in creative, innovative and high-technology industries in the SPECA region;
- Capacity-building to facilitate the effective regulatory protection and enforcement of intellectual property rights and strengthening their role in innovative development;
- Facilitate the dialogue of governments, the private sector, consumers, researchers and civil society in these areas;
- Facilitate the dissemination of good practices and exchange of relevant experiences: to give consideration to the establishment of a SPECA Project Working Group, dealing with innovation, competitiveness and intellectual property rights.

## **6. Cooperation in the agrarian and processing sectors**

A blueprint for creating an international food consortium should define the main aspects of a coordinated agricultural policy of Central Asian countries on ensuring their food security.

Implementing these aspects requires the adoption of specific practical measures to increase the competitiveness of the Central Asian economies' agricultural sector:

- Adopting modern technology in crop and animal farming and increasing crop yields;
- Attracting foreign investment and experience to develop the agricultural sector of Central Asian countries;
- Changing the structure of farmland, strains and types of crops taking into account the need to meet the food demand of the population;

- Creating interstate clusters to produce foodstuffs (rice, grain, dairy and meat products, juices and tinned vegetables and fruit); and
- Building an innovation infrastructure.

The main element of the innovation infrastructure should be technology parks, which aim to develop and adopt progressive technology for producing farming products.

Taking into account international experience in building and developing innovation infrastructure, it is expedient to set up technology parks as special economic zones (providing financial incentives: tax, tariff rates and so on), so that they can function efficiently.

Expanding cooperation between Central Asian countries in the agricultural sector requires coordinated tariff and tax policies:

- In tariff policy, it is important to draft common anti-dumping and special protectionist measures in trade with third countries;
- In tax policy, it is expedient for Central Asian countries to coordinate measures to create a favourable tax regime for joint interstate clusters in the food industry.

These measures to develop cooperation between Central Asian countries in the agricultural sector require the adoption of a number of intergovernmental agreements on expanding cooperation in the agricultural sector and creating interstate clusters in the food industry and free economic zones.

In general, the blueprint for creating an international food consortium would help Central Asian countries to pursue a coordinated agricultural policy, increase the sector's competitiveness, strengthen the food security of the region, supply high-quality goods to the regional market and create a common agricultural market in the future.

## 7. Increasing investment in the processing sector

Improvements in the regional trade and investment climate would attract intra and extraregional investment in the processing and manufacturing sector of Central Asian countries, including the development of regional clusters.

It is time to take efficient measures to develop regional cooperation in the area of processing natural resources and set up production with high added value, not only to supply countries of the region but also to export to third countries. This cooperation can be implemented by creating multinational financial and industrial groups and joint enterprises.

Expanding cooperation is important in the following sectors:

- **In the oil-processing sector**, it is promising to set up joint ventures with modern technology for refining oil. In addition, it is feasible to set up an interstate cluster comprising Uzbekistan's Fergana and Bukhara oil refineries and Kazakhstan's Atyrau, Pavlodar and Shymkent refineries. These refineries can jointly help Central Asian

countries to pursue a coordinated policy on developing the oil processing industry and building a common petroleum products market in the future.

- **In ferrous metallurgy**, it is necessary to expand cooperation to increase the quality and competitiveness of iron, manganese and chromium ores and develop production with higher added value. In particular, the creation of enterprises to produce bar iron, high-quality steel and pipes is very important in modernizing the oil and gas transport infrastructure in Central Asia. In nonferrous metallurgy, the priority aspects are cooperation in applying modern technology for the production of polymetal concentrates, the comprehensive processing of initial ores, the secondary processing of scrap metal, radioactive scrap metal and waste, and increasing the output of rare and precious metals. The creation of joint enterprises to produce gold is also a promising aspect (major gold mines are located in the Kyzylkum desert in Uzbekistan, whose current output is 80-85 tons a year. Uzbekistan intends to increase this figure to 140-150 tons. It is therefore feasible to attract regional and foreign direct investment in Uzbekistan's gold industry).
- **In uranium extraction and processing**, it is important to expand cooperation between enterprises from Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan and to adopt measures to modernize mines and ore-enrichment enterprises, as well as to conduct joint scientific research and a coordinated policy on entering the international markets.
- **In cotton processing and the textile industry**, it is feasible to set up an interstate cotton cluster with a full industrial cycle (from picking cotton to producing high-quality fabrics). It is important to attract foreign investment in joint textile facilities.

Implementation of these projects envisages drafting and adopting relevant intergovernmental agreements, which will become an important factor in developing the processing sector of the Central Asian economies and increasing its competitiveness.

The development of the processing sector of the Central Asian countries also needs large-scale foreign investment, including from EU member countries.

## **8. Coordination of labour migration policies and creation of a common labour market**

Central Asian countries could consider the setting up of an interstate migration centre, which would monitor internal labour markets in Central Asian countries, create conditions for using the combined labour potential efficiently, ensure the organized movement of labour, adopt measures to create favourable living and working conditions for people in any Central Asian country considered.

In order to resolve these issues, it is feasible to adopt a joint regional labour migration policy and a plan of action to implement it. The elaboration and implementation of these documents would require the active involvement of the International Development Community, including the EU.

An important stage in forming a common labour market is the creation of a common educational space. Moreover, it is important to take measures to unify the labour legislation of Central Asian countries, ensure social and pension guarantees, develop the professionalism of the labour force and adopt modern market-economy standards in personnel policy.

The development of a regional labour market would require the unification of the labour legislation of Central Asian countries and the adoption of adequate changes to the labour codes of Central Asian countries.

The elaboration and implementation of these documents would require the active involvement of the International Development Community, including the European Union.

### **Conclusions**

Progress in regional cooperation and integration in Central Asia would help to expand trade and investment ties between these countries. Active involvement of the International Development Community, in particular the UN and the EU in the implementation of recommendations contained in this study through increased technical cooperation assistance, would significantly contribute to the sustained economic development and stability of the region as a whole.

## ANNEX

The authors of the study polled the opinion of experts of various ministries in their countries, which receive technical cooperation assistance from members of the International Development Community. The answers revealed a need to involve experts from the recipient countries in a more substantial way in the elaboration, implementation and evaluation of technical cooperation assistance projects.

1. Preparation of Terms of Reference of projects on technical cooperation assistance as a rule is assigned to international experts employed by the donor organization or to international consultant organizations. This sometimes leads to insufficient use of recommendations by local experts, who have in-depth knowledge of the sector in question. As a result, the preparation of projects on technical cooperation assistance is often based on a less-than-complete assessment of local needs and requirements and this in turn reduces the effectiveness of implementation.

2. Projects on technical cooperation assistance rarely channel resources to local experts or researchers. Too often a large part of the resources assigned to the implementation of these projects is spent on the services of foreign experts or consulting companies even in cases where (part of) the required expertise is available locally.

3. The duration of projects not always corresponds to the length of time required to achieve sustainable results. In some cases donor organizations realize in the course of implementation that in order to increase the effectiveness and sustainability of a project it would be necessary to continue implementation (of some of its components) in the future. However, due to insufficient attention to the requirement to ensure sustained effect, capacity-building activities often remain unfinished.

4. Departments benefiting from technical assistance complain about the incorrect selection of pilot regions for the implementation of technical assistance projects. Very often, organizations implementing a given technical assistance project choose a pilot district which is close to the capital or another large city and has good infrastructure. However, according to local experts, there are a number of other regions where results could be more effective and useful for the country.

5. Poor regulation and control mechanisms. Beneficiary organizations consider that several donor organizations have less than fully effective operative regulations and control of the outcomes of technical cooperation assistance projects.

### **What needs to be done to improve technical assistance?**

In the opinion of the authors, recently progress has been observed in aligning projects by the International Development Community and in particular the European Union with the needs and priorities of the recipient countries. Nevertheless, some problems remain.

It is necessary:

- To strengthen links between the European Union projects and the budgets of the recipient country. Further development of sector-wide approaches is needed;
- To strengthen coordination between the EU and other donors and to involve the recipient Governments in the harmonization and coordination processes;
- To not always consider Central Asia as a single region when developing technical assistance projects. Support to efforts to improve bilateral or, in some cases, multilateral relations is necessary in addition to support to regional cooperation;
- To use, whenever feasible, the services of local experts and consultants in the process of drawing up Terms of Reference and in the general preparation and implementation of projects on technical cooperation assistance. Local think-tanks and research institutes can render significant assistance in elaborating solutions to many problems of regional cooperation, including those discussed in this document;
- To provide more flexibility regarding the expenses structure of a given project in order to fine-tune it in the course of implementation, so that the project better meets the needs of beneficiaries, while fully respecting the fact that control of utilization of financial resources spent during the implementation of the project should remain with the donor organization;
- To coordinate all technical assistance projects carried out within a country through a single focal point in the Government;
- To increase the number of projects implemented by the International Donor Community, and in particular the EU, designed to improve the business and investment climate.

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