

II. CHALLENGES AND OPPORTUNITIES OF REGIONAL COOPERATION



The economies of the Central Asian republics need to transform if they are to move toward sustainable growth and poverty reduction. *Regional cooperation is a necessity.* The governments of the region have recognized their interdependency: There is a clear awareness of the need to address transport and communications systems from a regional standpoint; of the need to rationalize energy trade; in developing broad marketplaces for their enterprises; and in creating regional stability, which is a natural by-product of economic cooperation.

But there remain substantial barriers, detailed in the following analysis, to expanding the economic cooperation in Central Asia to a level of real value. Inadequate infrastructure, policies that emphasize self-sufficiency instead of trade, the absence of modern payment mechanisms and weak government systems are among the many impediments to cooperation.

The Landlocked Countries of Central Asia

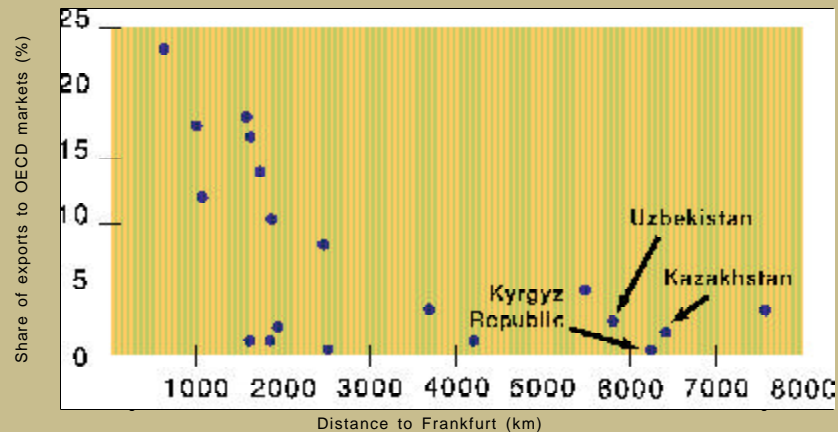
The geographic location of Central Asia inhibits the necessary communication and interchange of people that can stimulate development of new markets. It also hugely discourages foreign investment in most sectors.

Figure 1 shows how the simple factor of distance to industrialized markets has affected economic restructuring for East European and former Soviet Union (FSU) transition economies.

On the horizontal axis the figure displays the air distance between a country's capital and Frankfurt. This is used as a proxy measure of the distance to international marketplaces.

On the vertical axis is the 1993 proportion of total exports of the transition economy that were sold in the Organization for Economic Cooperation and Development (OECD)

Figure 1: Distance and Exports to Industrial Markets in European and FSU Transition Economies



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economies. This is used as a measure of the success of export market development and diversification. Of course, many other factors, such as the presence of civil strife, the progress of reform, and the resource base of the economy, help explain the evolution of exports after the breakup of the Soviet Union.

It is clear that those transition economies closest to Frankfurt had higher proportions of exports directed to industrialized markets.

A similar picture could be drawn between the distance to European markets and other variables, such as the shift of exports away from former Soviet bloc markets. The countries of Central Asia, being the farthest from European markets, have seen relatively little opening for their exports in industrialized marketplaces.

Long-term growth and sustainable development will depend to a large extent on the countries' ability to develop new industries to replace those propped up by the centrally planned Soviet economy in order to restructure their economies. For Central Asia, growth will come from new markets for products and raw materials, as well as new sources of industrial inputs and supplies, and in overcoming the challenge of its physical location. In the context of regional economic cooperation, this could be achieved.

TRADE

Take away the safe, Soviet-style environment of artificially created high demand for output and no industry competition and economic confusion quickly comes to roost. In wrestling with the reality that independence created, the Central Asian governments have moved, though unevenly, through privatization and the introduction of market-based incentives to foster trade liberalization. Prices have been freed on most goods and services. Production, trade and demand are recovering, though complaints on the dearth of goods have been replaced with cries against the high cost of items.

Strides also are being made to establish the legal and regulatory framework necessary for the smooth functioning of market-based economies. The same is true in Xinjiang, where, unlike the Central Asian republics, there has been economic growth in the past few years and structural reform has been solidly underway since the 1980s.

Though regional trade has clearly developed in the decade of independence for Central Asia, its growth has been uneven at best. If this experience does not improve, there will be no basis for the region to truly grow and prosper. The potential for expanding intra-regional trade in products ranging from natural gas to shoes, from melons to electricity, remains considerable.

Intra-regional trade benefits all: The buying country meets its demand for consumption/production without having to ship in goods from great distance; the selling country gains without incurring large transport costs and by enlarging the scale of its production, which drives down costs further.

Indeed, the trade between Xinjiang and the Central Asian republics shows just this pattern with skins and hides, steel and cotton moving east and Chinese consumer goods moving west. Energy is another obvious candidate for expanded trade. As discussed more in the following sections, the Central Asian countries possess large and complementary resources. Expanded trade of one country's energy resources for that of its neighbors would benefit all.

Despite the common interest toward increasing trade, all the countries in the region have trade-restricting policies and practices. Country by country, there are the barriers of tariffs, public policies, procedures and regulations and weak financial systems.

- Tariff constraints to trade may be relatively minimal. But in some cases the Central Asian governments impose export taxes on goods shipped from one country to the next, resulting in a double taxation that discourages exports and depresses trade volumes. In 1999, Kazakhstan also temporarily imposed a 200 percent tariff on selected goods from the Kyrgyz Republic and Uzbekistan. This measure was a response to the Russian financial crisis and the sharply devalued ruble that threatened to inundate the region with suddenly cheap Russian goods. The episode passed without major disruption to ongoing trade but renewed the sense of fragility in regional relations.
- Policy-related constraints to trade include import quotas, export licensing requirements and transport restrictions. The use of import quotas by the PRC, for example, limits trade between Xinjiang and the Central Asian republics. In all countries, there remains a tendency to view trade as a zero-sum game in which someone wins and someone loses. This misconception supports laws and regulations encouraging exports and discouraging imports—a situation that cannot help but discourage trade in general.
- Procedural and operational barriers to trade include a variety of impediments. Cumbersome, arbitrary and often corrupt bureaucracies throughout the region administer regulations that are archaic and frequently conflicting. Regulations change often, usually without notice. There are slow, difficult border procedures, multiple cargo inspections within a single country and prohibitions that prevent vehicles from transporting goods between countries. Increasingly visa procedures limit travel and private trading.
- Other barriers to trade include transit fees and the costs of dealing with corrupt border officials and local police. Trade is also restricted by such practices as requiring importers to register contracts and currency conversion restrictions. In no country is there a healthy financial system that provides modern services to facilitate trade. Indeed, much trade is supported by inefficient cash transfers or barter.

Intra-Regional Trade of Goods

Exports	To: Kazakhstan Kyrgyz Republic Tajikistan Uzbekistan Xinjiang, PRC				
From:					
Kazakhstan		Petroleum, coal, wheat, nonferrous metals, chemicals and plastics, machinery	Wheat, flour, petroleum products, tractors	Gasoline, wheat, clothing, chemicals, rubber, copper, wool, meat	Steel, ores, fertilizer, textiles, hides, cotton
Kyrgyz Republic	Electricity, antimony, sulfur, tobacco, ores and scrap, textiles		Asbestos and cement, flour, natural gas	Electricity, meat and milk, coal, ores and scrap, wool, cloth, sugar, medicines	Hides, wool, cotton, metal
Tajikistan	Aluminum, ore, ethanol, fruit	Electricity, ethanol, ore		Electricity, aluminum, rail services	Cotton
Uzbekistan	Natural gas, electricity, cotton, consumer goods	Natural gas, fertilizer, fuel oil, gasoline	Petroleum products, fertilizer, cement, fabric		Cotton, fertilizer, wool
Xinjiang, PRC	Clothing, food, sugar, electronic goods	Clothing, shoes, construction materials	Cars	Clothing, shoes, electronics	

Source: Asian Development Bank, *Regional Economic Cooperation in Central Asia*, July 1998.

If the issues noted can be successfully addressed and the transport systems improved, regional trade will rise because of the distance to other markets, cultural similarity among the people of the sub-region and common patterns of consumption. As experiences across the world show, a common market and general prosperity increase trade, which in turn strengthens competition and accelerates technological advances. Regional trade in Central Asia is a win-win situation: It can benefit all.



ENERGY

Central Asia happens to be abundantly endowed with energy resources. It also serendipitously stands between two of the world's largest markets for energy: Europe to the west and Asia to the east. Following some direly needed improvements, such as extensive repair and expansion of the transport infrastructure, Central Asia could become a regional bloc for trading, transport and sales of energy.

Within the region there is a sharply uneven distribution of energy resources among each country. This means that each republic has something the others need. Kazakhstan has ample supplies of oil and coal; both the Kyrgyz Republic and Tajikistan are potential suppliers of hydroelectric energy; and Uzbekistan's gas has natural markets in Kazakhstan, the Kyrgyz Republic and Tajikistan. Even Xinjiang, which has extensive stocks of oil and coal, stands as a potential market for oil from Kazakhstan because of the needs farther east for oil.

The energy sector is a natural magnet for economic cooperation. But because of each government's post-independence apprehension of being dependent on outside sources for energy, agreements are not so easy. Generally, national policies so far have favored self-sufficiency and substitution even at the expense of trade and rationalization of energy use. The failure to move to new agreements, based on market realities, has left energy trade in a complex structure of state-to-state barter arrangements that often reflect the earlier Soviet mode.

National policies are not the only constraint on developing greater intra-regional trade. There are also the tremendous problems with the physical infrastructure. And slow economic growth factors in heavily. Physical infrastructure, such as new pipelines and electric transmission lines, as well as improved rail capacity and storage facilities, would be required in some cases to expand energy trade. These infrastructure projects are expensive, and

detailed studies would be needed to determine whether they are feasible. In other cases, a coordinated program of rehabilitation and operation is necessary.

Economic contraction and the slow pace of economic growth in the region have had a negative impact on the ability of countries to pay for energy imports and this has slowed the development of energy trade. In addition, the countries have been unable to agree on acceptable prices for energy resources. In the long run, production and transportation costs will have to be in line with world markets to keep the trade competitive. If the cost of producing and shipping Kyrgyz electricity to Xinjiang, for instance, is more than the cost for the PRC to build its own coal-fired electric plant in Xinjiang, then the PRC will have little interest in buying electricity from the Kyrgyz Republic. Similarly, Uzbekistan gas and Kazakhstan oil will need to be produced efficiently to compete in world markets.

Despite these problems, there have been several favorable movements toward mutual solutions to meet respective energy needs. *Supported by the ADB, the Central Asian governments have set the rehabilitation and improvement of an interconnected electric power grid in the region as a high priority. This grid will provide the basis for expanding electricity production and export as well as stabilize electricity supplies throughout the region.*

Another proposed project is the completion and renovation of the gas pipeline from Turkmenistan and Uzbekistan through the Kyrgyz Republic to Almaty in Kazakhstan. The project could eventually involve the transshipment of gas from Central Asia to East Asia. But before the massive investments needed for the longer-term project are considered, the policies and infrastructure within Central Asia toward energy sales and transshipments need to be improved.

TRANSPORTATION

Roads and rails not only transport Central Asia's trade products, they are the avenues shuttling the economic hopes of each government. And they are not in great shape.

International experts estimate that 1,500 kilometers of roads in the region deteriorate each year, and that capital repairs have been well below annual requirements for years. Many rails use discarded track from Siberia, which makes for slow-speed traffic and frequent breakdowns. Rolling stock is poorly maintained. Both road and rail networks reflect outdated priorities.

Corridors between the Central Asian republics and Xinjiang are limited, because of the previous acrimonious relationship between the Soviet Union and the PRC.

For similar reasons and reflecting the often mountainous conditions, passage between Central Asia and South Asia is even more restricted. The former economic integration of the Central Asian republics within the Soviet Union drove their transportation infrastructure toward European Russia, especially Moscow. The roads were developed to serve the monolithic Soviet economy and links with neighboring countries had no priority.

There is one major paved road corridor connecting the countries in Central Asia—the east-west highway that links Tashkent with Almaty. This road runs beyond both of these cities, to the southwest of Uzbekistan, with further links to Turkmenistan, to the Kazakhstan-PRC border at Horgos and onward to Urumqi in the east. Portions of the road have been upgraded in Xinjiang, but major reconstruction of several sections of the road is still needed.

Expanding economic trade is dependent upon the moving of goods cheaply, quickly and effectively across the region. Making the necessary improvements requires huge investments and a coordinated policy. It would do little good for one country to rehabilitate the roads to a border only to find the road on the other side impassable.

All countries must coordinate their rehabilitation work and all

countries must work together to ensure that the policies of each encourage trade and traffic.

Rail is the most important mode of transport in the region, accounting for more than 75 percent of all freight and a significant percentage of inter-city passenger transport. The existing rail network already links the major cities and industrial centers of the region, and coverage is generally sufficient for current and near-term levels of economic activity.

For long-term plans, the critical gaps in rail coverage are a problem. In particular, the single rail corridor connecting the Central Asian republics with the PRC is a potential impediment to trade. All trade must pass through the Druzba-Ala Pass at the Kazakhstan-PRC border, and the countries in the region have disagreed about transportation access and settlement of accounts. Constructing rail or providing for inter-modal connections between the Uzbek and the PRC rail systems would reduce the pressure on this potential choke point and provide significant internal benefits to the Kyrgyz Republic.

Freight volumes on the region's roads are increasing as a percentage of the transportation mix. Trucks can provide flexibility in distribution, particularly for the emerging small traders and new businesses of the post-Soviet era. As with the rail system, the road network of Central Asia is generally sufficient in the sense of linking together the major population, commercial and industrial centers.

More urgent than new construction is the need to upgrade the existing roads to meet the demands of future economic growth and activity. Most of the network is badly deteriorated as a result of poor construction and the lack of maintenance. The roads were not built to support the large volume of heavy trucks that are appearing. Travel is often slow with considerable wear on vehicles and damage to goods.

The governments in Central Asia have proposed projects to

The New Silk Road: Modern Land Bridges

improve the major highways. Financing remains a major obstacle. Each country has severe budget constraints and private investors usually are reluctant to invest in transportation infrastructure projects because of the difficulty generating revenues.

The policy environment affecting cross-border transit is as important as the physical conditions of the roads and rails. Corrupt, self-interested and untrained personnel can block a highway as surely as a landslide. Other problematic issues include unscheduled closures of border-crossings, inadequate border crossing facilities and procedures, transit restrictions and charges and poor control by police and other authorities along corridors.

The governments have moved to improve transit in the region. As a possible model for future action, the ADB has been asked to jointly finance the rehabilitation of the highway linking Almaty in Kazakhstan with Bishkek in the Kyrgyz Republic. This joint loan/grant project will be supported by the European Bank for Reconstruction and Development and the European Union.

As a crucial element in the rehabilitation, the two governments have committed to a Cross-border Agreement to ensure that inter-country travel and trade are encouraged.

A future project is the development of multi-modal transport corridors, such as a rail-road-rail corridor between Ferghana Valley and the PRC that would use rail from Uzbekistan to Osh in the Kyrgyz Republic, road to Kashgar in the PRC and then back to rail for any remaining distance.

One key to the success of such a project would be to establish adequate container handling equipment for the transshipment of containers between rail wagons and road vehicles. This combined road/rail route would significantly reduce transport distances to Asia and would be extremely attractive for container transport. The infrastructure and increase in traffic might also improve the opportunities for economic development along the transit corridor.

In more recent times, Central Asia has been crossed by so-called continental land bridges. The first of these was the Trans-Siberian Railroad, built between 1891 and 1904, which connects St. Petersburg and Moscow to the Pacific port city of Vladivostok. This 5,800-kilometer railroad is still the longest single line of track in the world. One section of the Trans-Siberian Railroad crosses Mongolia and connects with a rail line in the PRC that reaches Beijing.

Additional railroads constructed to meet the Soviet Union's strategic needs for minerals and raw materials linked Moscow and eastern parts of the Soviet Union with the "Middle Asian" or Central Asia region. These lines eventually extended from Rotterdam in Western Europe, through the Kazakhstan-PRC border crossing at Druzba, to Xian and Lianyungang in the PRC. The lines became known as the second continental land bridge.

A third continental land bridge refers to the rail linkages from Istanbul to Tashkent, via Iran and Turkmenistan. This rail line enters Tajikistan and the Kyrgyz Republic, but does not extend through either of these territories to reach the PRC. Leaders within the region are hoping to complete this southern land bridge so it can be an alternative to northern routes through the Russian Federation.