The Economic Future of Central Asia

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ECONOMICS AND POLITICS HAVE ALWAYS been strongly interconnected in Central Asia. The five Central Asian republics were, together with Azerbaijan, the poorest Soviet republics. Their role in the Soviet division of labor was limited to supplying a small range of primary products, including cotton, oil and gas, and minerals. With no prior history as independent nation states, the five countries faced an uncertain future after becoming independent in December 1991. At that time, they faced three major economic shocks: the end of central planning, hyperinflation, and the collapse of supply and demand chains.

Despite the challenges, three of the countries have been politically stable since independence. In Uzbekistan and Kazakhstan, the two most populous countries, the First Secretaries appointed by Mikhail Gorbachev became national presidents in 1991 and are still in power. In Turkmenistan a similar pattern was scarcely disrupted by the president's death in 2006 and the smooth succession by a member of the elite. By contrast, Tajikistan experienced a bitter civil war until 1997, and the Kyrgyz Republic has seen two presidents overthrown during the 2000s. The differing fortunes reflect the ability of the first group to live off their natural resources, in comparison with the more precarious resource base of the other two countries.

The first section of this paper reviews the five countries' economic history since independence, with an emphasis on the direct and indirect impacts of each country's resource endowment and variations in the world prices of their resource exports. The second section looks to analyze the extent to which the past can be a guide to the economic future and to ask what other considerations may be

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important. These considerations include the role of other countries, especially Russia, China, and the United States, and the importance of the national leader's specific qualities in economic policy making in autocratic states.

The Past

The story of the five Central Asian countries' economic development since independence has by now been widely analyzed.[1] In the 1990s debate over post-Soviet transition strategy, Central Asia saw a wide range of positions. The Kyrgyz Republic was the most radical of any Soviet successor state in its pursuit of comprehensive price and trade liberalization and extensive privatization between 1993 and 1998. Indeed, it was the first of these states to join the World Trade Organization (WTO), ahead of even Baltic countries. This experience stands in contrast to less thoroughgoing reform found in Kazakhstan, a more gradual approach in Uzbekistan, and an overall lack of reform in Turkmenistan, which remains the least changed economy of any former Soviet republic. Economic performance, measured by real GDP in 1999 as a percentage of 1989 GDP, showed little relation to the transition strategy. Uzbekistan's economy was the best-performing of all former Soviet republics and, unsurprisingly, the worst-performing Central Asian economy was that of war-torn Tajikistan. However, the other three countries had more or less identical performances, with GDP about a third lower in 1999 than in 1989 despite the diversity of transition strategies.[2]

The main explanations of Uzbekistan's success emphasize the gradual transition strategy, favorable world market conditions for its major export (cotton), and good administration (and favorable inheritance from the Soviet era).[3] Gradualism reduced the magnitude of the short-term transitional recession compared to countries adopting rapid reform. Good administration helped to reduce the decline in output (e.g., the maintenance of irrigation channels and ginning facilities kept cotton output up), in contrast to the decline in cotton output in Turkmenistan and Tajikistan. However, what transformed these factors into the best performance in the former Soviet Union was the 1992–1995 upturn in world cotton prices (Figure 1) combined with the relative ease of transporting cotton, a high value-to-bulk commodity, to world markets.

Turkmenistan, the second-largest cotton producer in Central Asia, also undertook gradual—or nonexistent—reform and, as in Uzbekistan, the government reaped substantial rents from cotton exports from 1992 through 1996. In both countries, the revenues from cotton exports, which were easily controlled by the state, reduced the pressure to push ahead with economic reform.[4] Both governments used the revenues to adopt some populist policies to maintain public support and to strengthen the security apparatus.[5] There were also significant differences in that Turkmenistan's President Saparmurat Atayevich Niyazov, better known as "Turkmenbashi the Great," spent on lavish monuments and established a personality cult.

When cotton prices fell in the second half of 1996, Uzbekistan resorted to draconian foreign exchange controls to maintain state control over the rents from cotton. The controls bred a series of policies injurious to a well-functioning market economy, while the systemic nature of the controlled economy inhibited further gradual reform. Turkmenistan also responded to falling cotton prices by increasing controls over its economy and was further hit when the buyers of its other major export, natural gas, failed to pay their bills.[6] Turkmenistan was, however, saved from economic disaster by the spike in oil prices and consequent increase in demand for gas. After the early 2000s, soaring gas revenues for Turkmenistan sustained the unreformed economy and autocratic president.

Kazakhstan had a potentially valuable resource in its western oil fields but needed the technology and capital of foreign oil companies to exploit the resource. The 1990s were a decade of negotiations and high levels of corruption, but they ended with major oil fields coming onstream at a fortuitous time. The world price of oil, which had stagnated in the dozen years before 1998, increased from under $10 a barrel in 1998 to over $140 in 2008. In the first decade of the 21st century, Kazakhstan was one of the world's ten fastest growing economies. President Nursultan Nazarbayev retained absolute power and enjoyed popular support as incomes soared. The President was not committed to tight economic control (apart from over oil revenues), and he encouraged moves to liberalize the economy and strengthen property rights. Increasingly concerned about his legacy, President Nazarbayev supported policies to increase human capital (e.g. by heavy investment in university education) and promote economic growth (e.g. by investment in industry and support for productive activities), contributing to the emergence of civil society.

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The Kyrgyz Republic embraced rapid change and created the most liberal regime in the region, becoming in July 1998 the first Soviet successor state to accede to the WTO. Like Kazakhstan, the Kyrgyz Republic opened its doors to foreign investors with the technology to exploit its undeveloped natural resources;

however, with only a single gold mine, Kyrgyzstan had less to offer.[7] The Kumtor mine, which accounted for a sixth of the country's GDP by the early 2000s, provided material for suspicion of corruption within the presidential circle, but not enough resources to buy or enforce public support. In 2005 and again in 2010, street protests led to the overthrow of the president, while poverty contributed to a severe outbreak of ethnic violence in 2010. Economic liberalization and flourishing small businesses, notably the traders at the huge bazaars outside Bishkek and Osh, have created a civil society disinclined to accept despotic leadership. It is less clear, however, whether the Kyrgyz model of a more open and less regulated economy will create prosperity and social stability.[8]

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In Tajikistan, the civil war destroyed the planned economy and effectively privatized economic activity without the legal institutions, such as security of contract, crucial to efficient operation of a market economy. After the 1997 peace agreement, the central government took control of the two major resources: a hydroelectricity and aluminum complex and the cotton sector. Nevertheless, the country remains impoverished, as neither cotton nor aluminum output is increasing. Domestic unrest is neutralized by emigration of the adult male population. At least one million of the country's seven million people—including many of the young men who would otherwise lead a revolt—work in Russia or Kazakhstan, sending remittances that help sustain the domestic economy above a desperate state. Since having been part of a superpower a quarter of a century ago, Tajikistan's national income per capita is now lower than the level in much of sub-Saharan Africa or in the poorest countries of Asia.

Many foreign observers expected relative economic performance in the second decade to reward those countries that had reformed their systems in the 1990s by attempting to create more effective market economies and to punish those countries that had held back on reform. In practice, outcomes were primarily (and overwhelmingly) determined by whether countries had energy resources or not. Kazakhstan and Turkmenistan enjoyed rapid growth driven by the rising world price of oil. Uzbekistan also benefited from an upturn in cotton prices late in the decade and from strong prices for copper and gold. The Kyrgyz Republic, with limited resources, benefited less, and Tajikistan did not benefit at all. As net energy importers, these two countries may have been harmed by world commodity price trends.

In sum, the economic trajectories of the Central Asian countries have been fundamentally determined by their specific resource endowments.[9] Uzbekistan and Turkmenistan were major cotton producers, although—as result of poor management—Turkmenistan no longer is, and Uzbekistan has gold and copper. Kazakhstan (oil) and Turkmenistan (natural gas) are major energy producers. The Kyrgyz Republic and Tajikistan have little besides their hydro-potential, which is difficult to develop without conflict with their downstream neighbors who depend on the water for irrigation. The differences in resources have dominated economic performance since independence, with the oil and gas exporters booming almost irrespective of their policies and the resource-poor countries performing much less well.

The Future

A striking feature of the years since 1999 has been the lack of further reform or of major structural change in the Central Asian economies. Central Asian countries responded in differing ways to the impression of a blank slate for reform in the early 1990s. However, by the turn of the century, the type of market economy had been fixed in each country and was now only amenable to limited further change as powerful vested interests defended the status quo. Thus, we may expect the past to provide a reasonable guide to the foreseeable economic future, which is likely to be dominated by what happens to world prices for cotton, oil and gas, and a few key minerals (especially gold and copper).

What else could affect future economic development? One difference between the 1990s and 2000s was increased external economic interest in Central Asia. After independence, much was written about a new "Great Game" (as in the 19th century competition between Russia and Britain) in which external powers would struggle for influence in Central Asia, but not much happened. Russia's influence gradually declined, but no other country stepped in to fill the gap.[10] However, rising energy prices, Russian renewed assertiveness in what Russian leaders often refer to as its "Near Abroad," and war in Afghanistan changed matters in the 2000s as Central Asia became a region of interest for all of the great powers.

To access the untapped energy resources of the Caspian Basin, various countries pushed competing plans for energy pipelines. Although plans on paper proliferated, investors were cautious in light of the high fixed costs of building a long pipeline, the volatility of energy prices, and potential security issues surrounding some routes (e.g. across the Caucasus or through Afghanistan to South Asia). Proposed projects were often mutually exclusive, given the relationship between pipeline capacity and available oil and gas.[11] In this competition, China—with an oil pipeline from Kazakhstan's Caspian fields and a gas pipeline from Turkmenistan through Uzbekistan and Kazakhstan—has been the clear winner. Since the early 2000s, China has also enjoyed booming exports of consumer goods to Central Asia.

Although Russia lost out in the pipeline contest, where it engaged in a losing battle to maintain a monopoly while being unwilling or unable to construct new pipelines, Russia has had notable recent success on the trade front. The Central Asian countries signed many trade agreements during the 1990s and 2000s, but implementation was negligible. In 2010, however, Russia, Belarus, and Kazakhstan began implementation of a customs union, which has become operational and likely to involve fairly deep integration. This step represents a major increase in Russia's influence in the largest Central Asian economy. Whether it will be in Kazakhstan's interests remains debatable, and the answer to that question will affect the customs union's sustainability.

The United States has become more actively engaged in the region since 2001, as Central Asia became an important part of the supply chain to troops in Afghanistan. U.S. presence is a political counterweight to the influence of China and Russia, although the economic importance to Central Asia of the northern supply route is not great and unlikely to be long-lasting given the imminent withdrawal of U.S. and other troops from Afghanistan. The United States has also played an active role in promoting oil and gas pipelines that will direct Central Asian exports to world markets. This was met with success in the early 2000s in promoting pipelines to Turkey and to Mediterranean ports but less success more recently in promoting a Trans-Caspian gas pipeline or supporting EU efforts to strengthen the pipeline network to southern Europe (the Nabucco project).

A more important factor than external actors is the possibility of changes on the domestic stage. In autocracies, the personality of the leader matters and this is especially true in Central Asia where super-presidential regimes concentrate power in the leaders' hands. Presidents Karimov in Uzbekistan and Niyazov in Turkmenistan have shown their willingness to be ruthless in maintaining absolute power and in retaining control over the economy (and the resource rents in particular), but they also differed in their approaches to using resource rents in a managed economy.[12] President Rahmon of Tajikistan, a former warlord, is similarly ruthless, maintaining control over the major sources of revenue (aluminum and cotton) with little apparent concern for economic theories.[13] The Kyrgyz Republic has the best prospects for democratic evolution, in part because

President Akayev went quietly in 2005—rather than turning to repression in order to hang on to power—as did President Bakiyev, albeit less amicably, in 2010.[14] Kazakhstan's President Nazarbayev is somewhere between these extremes, playing statesman on a wider stage and changing economic policies for the common good, as long as it does not affect his grip on power.

In 2012, the autocracies seem more stable than the Kyrgyz Republic. This will continue as long as the strongmen are strong, but there is potential for huge instability when the Kyrgyz president dies. Peaceful successions in Turkmenistan, where economic policy has changed only marginally since President Berdymukhamedov came to power after Turkmenbashi's death in December 2006, and in Azerbaijan, where son succeeded father, do not guarantee peaceful successions when either Nazarbayev or Karimov dies.[15] Even with a peaceful succession it is not easy to predict the next president, or whether he will be an economic policy making clone of his predecessor, as Berdymukhamedov appears to be.

The dichotomy between the more open and more closed Central Asian economies, as created by the transition strategy decisions of the 1990s, is also important for economic (and political) development in the long run. The openness of the Kazakh and Kyrgyz economies contributes to institutional evolution by exposing policy makers and civil society to external influences. Civil society is relatively strong in Kazakhstan, despite the restricted political system. Emphasis on competitiveness is associated with a more open-minded, evidence-based approach to economic policy. The Kyrgyz Republic has the best immediate prospects of democratic political reform and has relative economic freedom, but these benefits could easily evaporate if poverty remains widespread.[16] Closed economies, on the other hand, have less dynamic institutional evolution as their population is not exposed to external developments or opinions. Uzbekistan enjoyed favorable initial conditions in terms of administrative capacity and from 1993 to 1995 adopted a pragmatic approach to economic policy, but after 1996 foreign exchange controls led to an inward-looking strategy with a discouraging environment for foreign investors and policy stasis. Meanwhile, its economy, closed off from external influences, was not exposed to influences that might stimulate change. Turkmenistan is still more isolationist, and even a change in president has not resulted in significant reform of an obviously malfunctioning economy.

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Conclusion

This paper has examined the interaction of policy choices and external events, notably world commodity prices, in driving economic developments since independence. The economic future will depend upon: (1) world prices of energy, key minerals, and cotton, (2) interests of external powers, especially Russia, China, and the United States (including the withdrawal of U.S. troops from Afghanistan and its consequences), and (3) internal developments (especially the political succession in the two largest countries, but also less predictable prospects of change in the two poorest countries).

World prices of energy, gold, copper and other minerals important to Central Asian countries are notoriously difficulty to forecast. That presidents Karimov (born in 1938) and Nazarbayev (born in 1940), both with reported health problems, will not rule forever is obvious, but what will happen to Uzbekistan and to Kazakhstan after them is less predictable. The balance of economic power between Russia, the United States, and China is more stable, as both China and the United States will be wary of the other's increased influence in the region. Neither will be too disappointed, however, to have a counterweight to Russia's historically dominant influence.

Appendix

Figure 1. World Cotton Prices (Cotlook A index), U.S. cents per pound

Notes

1. My own version is in *The Economies of Central Asia* (Princeton: Princeton University Press, 1995), *The Central Asian Economies since Independence,* (Princeton: Princeton University Press, 2006) and "Central Asia after Two Decades of Independence," in *Economies in Transition: The Long-Run View*, ed. Gerard Roland (Basingstoke: Palgrave Macmillan, 2012), 400–29. In the following notes, where no reference is cited details are in my 2006 book.

2. Data taken from the national accounts of the Central Asian countries should be treated with caution, especially for the 1990s, but there is little argument about the rankings of the five countries' performances in the 1990s.

3. Corruption was, and still is, widespread in all of Central Asia, but available evidence suggested lower levels in Uzbekistan than in the other four countries. Among the 20 transition economies covered by the 1999 Business Environment and Enterprise Performance survey (reported in the European Bank for Reconstruction and Development's *Transition Report 1999*), Uzbekistan ranked about fourth for lack of corruption, ahead of several European countries generally considered to be transition leaders.

4. Cotton marketing is relatively easy to control because raw cotton is bulky and is typically taken to the closest gin for processing. In both Uzbekistan and Turkmenistan, state agencies control marketing of the cotton fiber produced by the gins. Some raw cotton is smuggled across the border from Uzbekistan into the more competitive markets of Kazakhstan and the Kyrgyz Republic, but such opportunities are only profitable for producers close to the frontiers.

5. "Populist" hides the differences between Uzbekistan's maintenance of spending on health, education, and pensions. Turkmenbashi cut back on these services but offered free heating, bread, salt, and other essentials. The spending on repression is harder to quantify, but both countries managed to qualify for chapters in *Worst of the Worst: Dealing with Repressive and Rogue Nations,* ed. Robert Rotberg (Washington, D.C.: Brookings Institution, 2007).

6. Apart from a small pipeline to Iran built in 1997, Turkmenistan's gas was all exported via Russia with ultimate consumers in Azerbaijan and Ukraine. With the low pre-1998 oil prices energy markets were considered to be buyers' markets. Azerbaijan and Ukraine became increasingly tardy in paying bills. As a result, Turkmenistan cut off supplies in 1997 and only reached new agreements in 1999. The episode illustrated the precariousness of Turkmen's gas exports, which had no delivery alternatives to pipelines.

7. Kyrgyzstan had other potential gold mines, but none has been exploited on a large scale, in part because foreign companies have been discouraged by the political instability; Richard Pomfret, "Resource Management and Transition in Central Asia, Azerbaijan and Mongolia," *Journal of Asian Economics* 23, no. 2 (2012): 146–56.

8. Kaminski estimates that the Dordoi bazaar in Bishkek employs over 70,000 people, making it perhaps the world's biggest shopping mall. Customers come from the more repressed Central Asian economies, notably Uzbekistan, and the Kyrgyz traders develop skills and linkages that spillover into other businesses. See: Bartlomiej Kaminski and Gaël Raballandm, "Entrepôt for Chinese Consumer Goods in Central Asia: Re-Exports through Kyrgyzstan—A Statistical Puzzle," *Eurasian Geography and Economics* 50 (2009): 581–90; Bartlomiej Kaminski and Saumya Mitra, *Skeins of Silk: Borderless Bazaars and Border Trade in Central Asia* (Washington, D.C.: World Bank, 2010).

9. The nature of the resource and its development in the late Soviet era were important determinants of attitudes towards foreign investment. At independence, cotton and Turkmenistan's gas, which had been developed in the 1980s, were ready for export, while Kazakhstan's oil and Kyrgyzstan's gold were undeveloped and technically challenging; Luong and Weinthal argue that decisions on foreign ownership were crucial to the nature of development in Caspian energy producers. See: Pauline Jones Luong and Erika Weinthal, *Oil Is Not a Curse: Ownership Structure and Institutions in Soviet Successor States* (New York: Cambridge University Press, 2010).

10. The decline in Russia's influence reflected events in Russia, not in Central Asia. Individual companies played important roles, (e.g., Daewoo in Uzbekistan, Chevron in Kazakhstan, Bouygues in Turkmenistan), but these were not results of their home country's national policy. Expected competition between Turkey and Iran for economic influence in their co-religionists' markets did not take place. See: David Garcia, *Le*

Pays où Bouygues est Roi (Paris, Éditions Danger Public, 2006).

11. Although pipelines are efficient modes of transporting both oil and gas, there are reasonable alternatives for Caspian oil (e.g., railcars, or the use of barges across the Caspian to Azerbaijan's pipeline network). The main alternative for gas, LNG, requires expensive liquification and regasification facilities that only make sense for producers with ocean ports; the blooming LNG trade, from Qatar, Australia, Arctic Russia, Brazil, and elsewhere, is creating a world market which poses a threat to Turkmenistan's gas exports rather than a new technological opportunity.

12. Both Karimov and Niyazov grew up in Soviet orphanages, but personality similarities are few, and their relationship was frosty. President Karimov and his wife graduated from the Tashkent Institute of National Economy with economics degrees, and this may influence the desired impression of competent management. The source of President Niyazov's distinctive personality cult is unclear.

13. Some authors see President Rahmon's main contribution to economic policy as overseeing the drug trade. For more information, see: Letizia Paoli, Irina Rabkov, Victoria Greenfield, and Peter Reuter, "Tajikistan: The Rise of a Narco-State," *Journal of Drug Issues* (Fall 2007): 951–79.

14. Akayev, a physics professor who became president as a compromise candidate in 1990, was more willing to discuss economic matters with academic economists such as Anders Åslund, author of *How Capitalism Was Built: The Transformation of Central and Eastern Europe, Russia, and Central Asia,* (Cambridge UK: Cambridge University Press, 2007), and this may have contributed to his willingness to promote rapid economic reform. Neither his successor, Bakiyev nor President Rahmon of Tajikistan would have given time for such conversations.

15. Both Karimov and Nazarbayev are in their 70s, while Rahmon and Berdymukhamedov were born in the 1950s. Neither Karimov nor Nazarbayev has a son, which appears to rule out dynastic succession, even though presidential daughters are powerful in both countries.

16. The ethnic violence in the southern part of the country in spring 2010 highlighted the danger. Although many ethnic Russians had emigrated in the 1990s, the large Uzbek majority remained in their Kyrgyz homes in part because they enjoyed greater freedom than in Uzbekistan, including better conditions for producing and selling their crops—this despite ethnic conflicts in 1990 over land rights. In the next two decades, relations between Kyrgyz and Uzbeks in the southern regions were peaceful, but the violence reignited in May–June 2010. Whatever the catalyst for violence, poverty fuelled the increased ethnic tension.