

Energy Policy, Economic Cooperation, and Sustainable Development in Central Asia: the case of Uzbekistan

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LIST OF ACRONIMS

ADB	Asian Development Bank
APEC	Asia-Pacific Economic Cooperation
AsDF	Asian Development Fund
ASEAN	Association of Southeast Asian Nations
CABCD	Central Asian Bank on Cooperation and Development
CACO	Central Asian Cooperation Organization
CAN	Andean Community of Nations
CAP	Common Agricultural Policy
CAPS	Central Asian Power System (Central Asian Interconnected Power Grid)
CAREC	Regional Economic Cooperation in Central Asia
CBU	Central Bank of Uzbekistan
CIS	Commonwealth of Independent States
CMEA	Council for Mutual Economic Assistance
CPU	Communist Party of Uzbekistan
EBRD	European Bank for Reconstruction and Development
EC	European Community
EIA	Energy Information Administration
EU	European Union
FDI	Foreign Direct Investments
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
IDA	International Development Agency
IEA	International Energy Agency
IMF	International Monetary Fund
INOGATE	Interstate Oil and Gas to Europe
MERCOSUR	Common Market of South

NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organization
NIS	Newly Industrialized States
NMP	Net Material Product
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PCA	Partnership and Cooperation Agreement
PIF	Privatisation and Investment Fund
SBA	Stand-by Arrangement
SCO	Shanghai Cooperation Organization
SMB	Small- and Medium-Sized Business
STF	Systemic Transformation Facility
TACIS	Technical Assistance for Commonwealth of Independent States
TRACECA	Transport Corridor Europe-Caucasus-Asia
UDC	Unified Dispatch Center
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
UNO	United Nations Organizations
USSR	Union of Soviet Socialist Republics
VAT	Value Added Tax
WTO	World Trade Organization

I. Introduction

1.1. National Tasks in Global Terms: Between Opportunities and Constraints

While international division of labor and internationalization was deepening across the globe and thereby mutual dependencies among national economies through the institutionalization of international trade, movements of capital and labor migration were strengthened, quite the contrary was the case in the former socialist camp headed by the Soviet Union in the early 1990s. As a result of centrifugal trends, the Soviet republics which previously made up the one common country, found themselves on their way to independence. Being an integral part of the given process, Uzbekistan had also to face a choice of new development. The country started searching for a new model which would reinforce its national sovereignty and identity, but within the new rules of global economic and political order.

The new national development model suggested by the government was supposed to carry through the set of transition reforms in the political, economical, social and other areas of public life and reach the final strategic goal, i.e. a secular democratic state with a developed socially-oriented market economy and an open foreign policy. Domestic macroeconomic reforms, nation-building processes and integration within the world community were considered as simultaneous and indivisible elements in the new development conception. The president of Uzbekistan particularly emphasized that *"integration into the world community is only possible provided its conformity to the modern perceptions of a democratic state with a developed market economic system. Equally, the country could be modernized on the indispensable condition of its integration into the world community, i.e. through finding a deserved place in the international division of labor and active participation in creation of regional and global security systems"*.¹

By the declaration of its openness, the republic, thus, officially admits the integrity of its national development with sweeping global trends promoting interdependence and complementarities in the world economy. Therefore, one of the most important pre-conditions for the creation of efficient development mechanisms in Uzbekistan after independence is to set up an open economic system which could not only be characterized by traditional high ratio of import and export transactions in GDP, but also conceptually a model of national development whose instruments of domestic and foreign policies are closely correlated with and influenced by internationalization of world's economic life.

¹ Translated by the author from Karimov I. Uzbekistan na Poroge XXI Veka: Ugrozy Bezopasnosti, Usloviya Stabilnosti I Garantii Progressa. Tashkent, 1997, p.290.

As experience of world economic development shows, the epoch of the secluded development with the exclusive emphasis on internal sources is more and more outdated. Such an orientation is basically related to the irrational use of national resources and therefore becomes soon an impediment to economic and social progress on the way to a market economy. After almost 70 years of isolationist development, the factor of openness is going to play a positive economic and even more political role in pursuing domestic reforms. The benefits of a more open strategy in foreign economic relations in particular, are mainly connected to the following positive effects:

1. With the higher share of GDP involved into international turnover, the country may obtain qualitatively new, additional opportunities for acceleration and increase in growth of national income. Consequently, in such a case, foreign relations in general become a crucial factor of intensive economic growth.
2. Through the establishment of relations with the world economy, a country may enhance development of those market mechanisms and institutions which are either weak or absent at all. These issues may include, for example, competition policy, privatization processes, stock exchange, credit and insurance mechanisms which all together would promote the establishment of a multistructural economy with diversified property forms.
3. Development of trade relations on the commonly admitted international commercial basis allow to strengthen the price factor which is important in reducing serious trade distortions widely developed in the former system of resource distribution.
4. Given national priorities, the country may improve the commodities structure in its export by pursuing new structural policy. The share of products with high value added is steadily increasing against the background of diversification of export and expansion of geography of trade relations.
5. And finally, the most crucial thing is that the country takes the opportunity to develop bi- and multilateral cooperations with any country concerned; it defines its policy within international and regional organizations in accordance with its national priorities.

At the same time the process of globalization takes sometimes complex and controversial forms. It is not realistic to expect that it bears positive changes only and therefore, is able to solve all the existing problems. On the contrary, as further interdependence occurs between countries and regions, the young countries have to confront with a number of new appeals threatening their emerging economic and political systems. Economically, for instance, Uzbekistan has to face with the consequences of world economic cycles which have had little

effects on domestic processes before. Domestic economic sectors are still fragile so that to react adequately to foreign shocks, immediate inflow or outflow of capital, etc. From the point of view of the pursuance of domestic policies, one may even observe a certain loss of autonomy in administering domestic processes which in turn may seriously affect socio-political and economic stability in the country. In political sense, the republic, like all the other states of the region, is already resisting to the pressure of international terrorism, extremism, drugs traffic, trade in weapons and even people.

Hence, the achievement of higher economic growth and national living standards via adequate policy measures is going to be an integral part of a clear strategy on conflict prevention in its modern perception. This policy agenda includes first and foremost domestic reforms which are called upon to promote the realization of underused domestic economic potential. This potential, among other factors, is largely determined by the endowment with natural resources. During the rise in oil prices, there was a substantial shift of income from energy-importing countries, primarily industrial western countries and the third world countries of Asia, to energy-producing states of the Persian Gulf states. For example, the total GDP of the Persian Gulf's states in 1981 (about \$210 bln.) was 19 times that of a decade earlier, which was explained by the increase in prices rather than in volumes of oil produced and exported.² The question is whether industrialization in energy-rich Central Asian countries³ may have much to do with the similar "windfalls" from production and export of energy products. In addition, one of the most frequently expressed academic views remains that energy interdependence between the regional states is believed to contain still unrealized potential to enhance the so far faint patterns of much-needed regional cooperation in Central Asia.

The oil shocks of the 1970s triggered off some new approaches to analyze and discuss the problem of highly interdependent policy issues on national security in the context of economic and energy security. Moreover, the thesis that the countries with rich mineral resources would face faster economic growth, did not have support in real practice. On the contrary, the energy dependent countries did much better with the problem of high imported oil and could reach sustainable economic development with higher efficiency. At the same time, for most of the exporting countries unprecedented windfalls in the short-run became a source of huge domestic inefficiencies which on the contrary hampered economic growth in the middle- and long-run perspective.

² Kubursi A.A. (1984) Oil, Industrialization and Development in the Arab Gulf States. Sydney-New Hampshire

³ In the given context, Kazakhstan, Turkmenistan and Uzbekistan. Further references to Central Asia comprise also Kyrgyzstan and Tadjikistan.

In addition, the new role of natural resources in the world development has much to do with the growing importance of NGOs and other movements (like the “Greenpeace”, etc.) at international level. Such movements demand not only a cautious attitude towards the gifts of nature, but support also the use of environment-friendly technologies in production processes, and the reduction of wasteful consumption of primary resources in favor of a more efficient manufacturing of the available resources. These movements became largely popular in industrially developed countries as a reflection of fully democratic societies. In line with commercial purposes, they might be partly seen also as the reason of the trends that forced many industrial producers to transfer some of their production, especially the dirty production requiring low-skilled labour, from their home countries to the developing countries. In such cases, it might have inadequate effects on the public opinion in recipient countries, who do not feel direct social benefits, but only the ambitions of multinationals to exploit domestic natural resources as well as cheap labor force. In Central Asia the aforementioned problems are exacerbated not only by its remoteness due to immediate problems of the underdeveloped and at best obsolete infrastructure to boost its exports, but also by hidden rivalry between the great powers keeping to its own national and geopolitical imperatives over the region’s perspectives. After more than a decade of independent development only a handful of energy projects have been realized to diversify the traditional energy outlets, as well as to overcome deficiency and then secure efficiency in both, production and consumption of energy within the region.

The key to long-term success, however, is hidden in the policy measures directed towards institutional and structural reforms to build up a new economy with the diversity of property forms and competition on an equal footing, which did not exist in the former planned economy. The government is obliged to coordinate these activities by creating a sound domestic atmosphere that encourages those spheres in which Uzbekistan and other states may have potentially comparative advantages and positive social effects. It needs to strive for the improvements in export structure moving toward the articles with higher value added which may provide more sustainability in foreign exchange inflows. Energy and other raw materials are not only influenced by the ups and downs of international prices, but are also exposed to the risk of the speeded-up development of alternative substitutes.

To become competitive in global terms and succeed in domestic reforms would be to some degree an easier task if cross-border cooperation had already been well established in the region. It is worth noting that political science points at three main reasons for the establishment of regional unions. The first one is that countries may have common interests in

regional cooperation because of geographical proximity and common economical, social and cultural interests. Secondly, there seems to be some ideological considerations and motivations to set up and be unified within a common constitutional union. Finally, it must be a rational choice that favors economic aspects, i.e. when political actors conduct detailed analysis of losses and benefits from membership and, subsequently uphold regional cooperation if losses from membership are exceeded by potential benefits.⁴

The latter, in particular, could be figured out by the following:

- regional trade may expand through a wider access of producers and consumers of one country to the bigger markets of goods and services in other member states;
- better opportunities for the use of united, i.e. more significant, resources and markets in defining and development of new industries reflecting competitive advantages of the regional countries; expansion of intra-industry specialization in the framework of large-scale industries allowing to benefit from the economies of scale,
- enhancement of intra-regional competition which promote further competitiveness of goods and services initially on the regional level, and then on the global level too;
- intensification of scientific and technological exchange allowing better coordination of technological policies and concentration of programs and funds to stimulate further progress of science and technologies across the region;
- upbuilding and maintenance of all kind of adequate infrastructure, especially transport, communications, financial;
- better opportunities to defend their national and regional interests in bi- and multilateral economic talks with the more developed countries and regions, as well as on the level of international institutions.

There are several definitions of “economic integration” in academic literature.⁵ The variety of scientific schools studying the phenomenon of integration agree nevertheless on defining it as a complex, structural and multifaceted process. This kind of complexity requires to look at it in some structural way in order to highlight the features and realize its internal logic. Hence, its main substance could be qualified as strengthening of interdependence among the economies of countries, as a result of either purposeful activities of the governments in these

⁴ Jakobeit K. Teoriya Regionalnoy Integratsii. In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.5

⁵ For this see Micic M. The Theory of Economic Integration, in International Trade, St.Martin’s Press, New York, 1998, pp.441-443.

countries, or the initiatives backed by the private sector, often by multinational corporations, to draw their economies together. The first one is so called policy-led integration which focuses upon reducing trade barriers between members in order to create a free trade area or customs union. It may also go even further to institutionalisation of integrative efforts and harmonisation of various policies (fiscal, monetary, industrial, etc.). The second type is something different driven by investors-led activities, when the latter perceive the advantages from intra-regional integration compared to inter-regional integration. The first type may encourage the second one to reinforce the regional activities, however investors-led trends may also occur in the absence of specific policy measures. Moreover, in accordance with the aforementioned types of integration, regionalization may take place in trade and/or production level. The former touches upon trade issues with the subsequent removal of barriers to cross-border trade in goods and services, while the latter implies the liberalisation of barriers to cross-border flows of production factors (labor, capital) and technology. Representing deeper form, integration on the production level may thus require more comprehensive policy measures than those directed on the support of free flow of goods and services only.⁶

Also, integration is divided into a negative and a positive one if we look at the given process through the prism of some policy measures. Negative integration implies to take some steps called upon to eliminate protectionist barriers in order to stimulate the development of better economic relations between the countries covered by the integration union. Positive integration suggests a set of measures of coordination of industrial potential of country-members to the regional union, including the methods of industrial, fiscal and monetary policies.⁷

Equally, by the character of its activities, regionalism may be open-typed, as well as closed-typed. Open-type regionalism considers economic development and regional cooperation in the context of the whole world economic development, serving as some kind of an interim stage, a pre-condition to globalization in the entire world economy. In such a particular case, regional integration is considered to promote the viability of political and economic formations covered by the given regional space. Stronger interdependence and common

⁶ Micic M. The Extent of Regionalisation in World Economy, in International Trade, St.Martin's Press, New York, 1998, pp.512-514. Some others use the categories "market integration" and "industrial integration" to qualify the same trends. Market integration means the availability of specific guarantees for the free sale of goods on the markets, as well as the free movement of factors of production between the countries intending to set up an integration union. Industrial integration is based on the development of industries going beyond national boundaries in order to maximize benefits from the economies of scale in the framework of the whole regional union.

⁷ Bulat V. Doctriny Nadnatsionalnogo Regulirovaniya Ekonomicheskikh Otnosheniy. Moskva, 1984, pp.6-38; Faminskiy I. (ed.) Mejdunarodnye Ekonomicheskiye Otnosheniya. Moskva, 2001, pp.739-747.

interests of the member-states trigger regional competition and steps towards more openness in global terms. Contrary to that, closed regionalism could be defined as the orientation on both, national and regional efforts, with less commitments on full-scale liberalization in the course of global trends. A regional bloc is thus initially set up for the protection of regional interests in competition with other countries and regions and finally may lead to alienation of the region.⁸

Rich international experience of regional efforts since the first regional wave in the 1960s suggests that the political set of features is going to be more characteristic for the regional initiatives between the developed countries. Only the latter, as a rule, may afford the desired level of foreign economic liberalization which is necessary for integration, while certain aspects of relations in the integration process between emerging economies or states in transition may be either poorly developed or even absent at all. Therefore, relatively to the developed economies on the one hand, and - to the developing countries on the other hand, we may talk about the differences both in motivations and models, as well as the speed of integration process.

In particular, developed economies are obviously used to move towards integration with the perception of wider opportunities to realize their comparative advantages in global terms. Emerging economies may be generally driven by poor economic development and the perceived exigency of joining efforts in order to be more efficient in bringing forward their common interests in negotiations with relatively stronger partners. In addition, small economies may unite their forces to realize some concrete joint projects within the common strategy of industrialization. Also, integration unions may be set up by developing economies in addition to existing military and political blocs. Therefore, in all aforementioned cases the level of real economic interdependence may be not that high. It is an even more complex task to succeed in arranging integration processes between the countries with differences in the structure and the scale of economies, as well as between those being on various stages of economic development. This process is going to be smoother if the economies of countries forming a union are on more or less the same level of development.

A number of studies on regionalization across the globe have revealed the following prerequisites for these processes to be successful:

⁸ Kasymova N. Osobennosti Vzaimodeystviya Globalizma I Regionalizma. Ekonomicheskiy Vestnik Uzbekistana, 2001, N6; Simoniya N. Globalizatsiya i Neravnomernost Mirovogo Razvitiya. MEMO, 2001, N3.

1. Similar economic structures and the start-up of industrialization process. With economic structures and the level of industrial development being significantly different, there is high probability for a situation in which some countries will face direct losses as a result of dynamic effects. It finally may lead the integration process to a failure or stagnation, though it may be also of a short-run character, or somehow be offset. Until compensation mechanisms are created, the countries will seem to have little concerns in the realization of regional initiatives.

2. Similarities in socio-economic and political conceptions. Common socio-economic and political experience and goals, as well as the readiness to concessions may be crucial in reaching mutual understanding in multilateral negotiations. Political stability is an important pre-condition to a constructive approach and is necessary to cushion resistance and opposing views during integration process.

3. Step-by-step strategy. Ambitions should correlate with real opportunities. Gradual and pragmatic orientation on the development of new forms of mutual consultations and cooperation may be much more efficient than momentous propaganda of vain and ambitious goals. Successful integration requires both, time and patience; its entire purposes are unattainable through a big bang jump.

What are the implications of regionalization across the world in the past for Uzbekistan and whole Central Asia? In terms of common history, similar cultural traditions, the way of life and mentality of the regional peoples, as well as common economic, political and security challenges the young states are to confront with, the region is induced to look for the creation of common economic, political and spiritual environment. Central Asia has the territory of more than 4 mln.km² (18% of the CIS) which is rich in natural and labor resources. The latter make up more than 55 mln. people (19% of the total CIS population), with more than 40% living in Uzbekistan. It seems to be true that the countries have hardly found themselves in an ideal position to realize its political and economic strategy after the 1990s. Yet there is definitely some potential for accelerated growth and development in the regional perspective. One point to be stressed here is, that the expansion and strengthening of cross-border economic cooperation among the regional states would increase the possibility of these countries playing an important role as connectors in the various routes linking Asia and Europe. At the same time, it would induce economics of the region, which are too small individually, to form a stable and medium-sized market which could be much more attractive to desperately needed inflows of foreign capital. In addition, because of their different

endowment with natural resources and geographical characteristics, it would be a long way ahead for the countries to individually complete the transition to a market economy on their own efforts, and it would be inefficient. Only by forming a common market will they be able to deal with the movements of international economy and other economic regions.

Yet, the previous efforts of the Central Asian states to cooperate and coordinate their policies on the regional level and to promote common goals in various issue areas, have proceeded only slowly overall, reflecting difficulties between the states. This process took a controversial form in the past due to a number of specific reasons. Firstly, the countries were confronted with a complex process of socio-economic and political transformation, accompanied by a number of challenges of both, domestic and foreign character. As a rule, these problems were addressed by unilateral actions from the states which did not promote regional initiatives and even strained the interstate relations. Secondly, regional structures set up in the region, have mostly tended to be consultative in nature rather than consisting of bodies making and implementing decisions. If on the one hand, it might have been related to the peculiarities of the Asian business culture which might prefer informal relations without appropriate institutionalization and obligations, especially among the elites who had already good personal relations from the Soviet era; then, on the other hand, it might reflect an emphasis on the consolidation of new-found sovereignty of the states having little interests in pooling their sovereignty. Thirdly, throughout the past decade the countries remained largely the economies with primarily commodities orientation in their export which made the states compete in searching for the trading partners outside the region. At the same time, intra-regional trade experienced a faint pattern and even tended to decrease. Fourthly, regional policies have been basically associated with state-level activities. There has been less evidence of so called “soft regionalism” reflecting sub- and suprastate regional processes which was integral part of regionalism in other parts of the world. But some functional linkages in industry, for example in the energy sector, have been also formed. Finally, initiatives for active cooperation have to take the form of top down efforts which seemed to be explained by the peculiarities of political system in the regional states.

In this regard, the following questions may be put up: what are the further steps for Uzbekistan and the whole region in XXI century to be undertaken in the light of the necessary domestic reforms, strengthening sovereignty, and sustainability of a nation-building process on the one hand; and the perceived exigency for regional cooperation to resist the global threats on the other hand? May the new priorities in Uzbekistan’s development strategy on comprehensive liberalization of domestic political, economic and social life serve as a turning

point influencing the whole spectre of intra-regional relations given the country's economic and military potential in Central Asia? Are there sufficient objective opportunities for the regional states to rely on closer cooperative links with each other? Or will the countries continue with independent, multivectoral integration with the world community, while preferring regional relations to be on bilateral basis? Finally, what are the perspectives of regionalization in Central Asia in the light of policy strategies of major powers, such as the USA, Russia, China, Iran and the EU, towards each other and with regard to the region?

The Central Asian patterns seem to be further influenced by the degree of engagement from powerful external states. Obviously, much will depend on their direct involvement or non-involvement in a number of initiatives undertaken by the regional states. Stability and sustainable regional development in Central Asia are apparently also pre-determined by the construction of the new and diversified system of transport and pipeline network, both intra-regional and inter-regional, which are called upon to address the strategic tasks of securing a wider access to regional and global markets of goods and services. This is a great bottleneck on the way to the realization of integration potential of the region, since the structure, technical state and conditions of maintenance of the old system outpace international standards, while the new ones have not been built yet. In particular, the region falls short of the common system of transport corridors, international ports and airports, while the regional oil, gas and electricity pipelines are getting out of order which substantially affects the effectiveness of transportation of goods and services, including energy resources, both inside and outside the region.

1.2. The Goals, Tasks and Methodological Approach

In the light of the aforementioned, there are several issues which should be taken into consideration in the debates on Central Asian transition societies. The main goal of this work is to analyse and find out possibilities of the sustainable development of Uzbekistan through the prism of its energy policy and effective regional cooperation.

For this purpose, a number of tasks should be realized. In particular, we need, firstly, to analyze the strategy of socio-economic development in Uzbekistan in the light of political transformation and the nation-building process. Secondly, to reveal the substance of energy policy of Uzbekistan in the past decade and to discover its potential to contribute to the process of industrialization in the future. Thirdly, to debate general models of prospective national development. Fourthly, to scrutinize the role and contribution of the foreign sector to

the comprehensive integration of Uzbekistan into the world community in the sense of business climate improvement and the enhancement of financial and technological capital inflows to keep up domestic transformation process. Fifthly, to conduct a detailed analysis of regional efforts in Central Asia in the light of regionalization trends in the world; to highlight peculiarities and challenges of these processes in the region; and to shape possible prospects given local opportunities and foreign assistance.

In the given context, a two-pronged approach could be useful embracing systemic and modelling dimensions. The systemic one suggests to give a look at the development of Uzbekistan and the whole Central Asian region in XXI century through the prism of “national interests”. Such an approach may consist of the three intertwined aspects: stability and security, sustainable economic growth, and persistent integration process. All of the aspects are closely interdependent and strengthen each other. A more comprehensive approach to security suggests that poverty and underdevelopment are among the fundamental causes which create a fertile ground for the proliferation of various destructive forces, including international terrorism and extremism. Among the possible methods of counteraction in this case is the necessity to overcome the economic roots of proliferation of these evils by loosening pressing poverty problems. It supposes to have not only direct measures allowing people minimum social rights to meet their needs in education, medicine and other areas, but also the steps on creation jobs to have the sources of sustainable income which in turn could be reached through a complex of socio-economic reforms securing stable economic growth. Equally, economic and social reforms are impossible without making people feel safe in the streets, on markets, at work, or even at home. Hence, with domestic security and stable economic development in place, one may depend upon better opportunities in the world competition for foreign direct investments and benefit from international division of labor.

The second dimension is based on the development of different models with certain situations in a place in which losses and benefits are streamlined, both through a geoeconomic and a geopolitical view. The Central Asian states are to confront with the simultaneous tasks of political and economic transformation under the influence of various domestic and external political, socio-economic, cultural, technical, legal challenges. It encourages discourses on multiple choices and consequences of their strategies on both, the national and regional level, as well as in the light of single policy spheres. For example, the realization of pipeline and transport projects in Central Asia affect political and financial interests, as well as suggests the use of infrastructure facilities of the neighboring countries. It means that the regional states are forced to permanently search for a balanced approach, in order to coordinate first

their actions with each other, and then look at intra-regional interests through the prism of relations with the outsiders.

1.3. The Structure of the Research and the Sources of Information

The given research is an attempt to amplify all the aforementioned aspects through the prism of Uzbekistan's socio-economic policy agenda, with the emphasis on its political effects, both, domestically and across the region. **Chapter II** sets the scene with a broad socio-economic analysis of the Uzbek development, both, as part of the former Soviet system and as independent state after the 1990s. The government of sovereign Uzbekistan encountered the necessity to develop its economic strategy in the context of domestic socio-political developments. Thus the transformation process and the outcome of the reforms undertaken in the past decade, as well as the main contemporary challenges in different areas, are scrutinized here. **Chapter III** puts a particular emphasis on the developments in the energy sector which have played one of the strategic socio-political roles within the development agenda after independence. In terms of future economic growth, the importance of the energy is expected to remain, both, for domestic needs and exports. There is also an attempt to debate about possible models of development of Uzbekistan in the years to come given both, the domestic opportunities and a set of external factors. In **Chapter IV** a glance has been taken on the energy issue in regional terms. This issue acquires strategic meaning for the whole Central Asian intra-regional relations. The regional states remain strongly interdependent in energy, although a number of steps have been taken towards energy self-sufficiency by each country. The question here is to not only push forward regional cooperation, but also to solve existing energy problems through joining forces. On the other hand, the development of a energy resource base in the region does not confine to its local production only. The biggest challenge for foreign investors is still how to transport these resources to foreign markets. In terms of Central Asia's land-lockedness, the determination of pipeline routes acquires a particular geopolitical meaning. In this regard, these projects should be obviously scrutinized through the prism of higher interests to the region from main regional and non-regional outsiders, such as the USA, Russia, China, Iran, the EU; through national factors of the past developments in those states; intensification of bi- and multilateral relations of the Central Asian states with these powers; and the level of cooperation or rivalry between these main players. **Chapter V** suggests that the reforms in the foreign economic sector are crucial to the extent to which they contribute to the relations between domestic sectors and the outside world. Also the significance of foreign investment strategy, forms and methods of attraction of foreign capital are discussed here. While higher involvement in the development of

resource base is supported, the enhancement of processing industries is of crucial importance in the long-run. **Chapter VI** emphasizes the necessity of regional cooperation for Uzbekistan and the other states through a broad comparative and historical analysis of political and economic features of regional developments in Central Asia. It is also pointed out that regionalism in Central Asia remains a work still in progress the outlines of which are still being sketched and its structure not being fixed yet. In the given context, a few scenarios of possible regional patterns are also a theme of debate, based on the various theories of regionalism. The main features and outcomes of the work are summarized in the **Conclusion**.

The information on the developments in Central Asia are huge and diversified. While choosing and analyzing its sources, the main emphasis was put on some kind of neutrality between the views of regional academic circles and those outside of the region. The problem is that perceptions and definitions may sometimes be completely different when covering the same trends: Central Asian officials and scholars are used to refer to regional trends as "integration", while outside analytical reports operate more with "regional cooperation", pointing at the absence of even initial stages of integration, such as a common trade area and common economic space, which is the substance that reflects much closer coordination of both horizontal and vertical connections throughout the region. Nevertheless, the contribution of local literature is crucial, especially in form of official statements, speeches, reports; both, on daily public life and on academic events. For example, the book of the president of Uzbekistan I.Karimov "*Buyuk Kelajak Sari*" (*Towards the Great Future*) is only one of the series on domestic economic and political events in the republic, as well as security threats in XXI century in regional terms throughout the past decade.

Among very helpful academic discourses about Central Asia are also the "*Materials of the Conference "Stability in Central Asia in Post-Conflict Period"*", basically in Russian, with some English articles, published in Tashkent in 2002; "Alimov R. and others (eds). *Tsentrlnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost*" in Russian dealing with geopolitical and security issues in the region, publ. in Tashkent in 2002; a book named "*Interesy ES, KNR, Rossii i SshA v Tsentralnoy Azii*", round Table Materials debating the geopolitical involvement of the main powers in the regional trends, publ. in Bishkek, 2004; Diter H. *Regionalnaya Integratsiya v Tsentralnoy Azii. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995* on regional cooperation in Central Asia; and a book published within the Project on "Conflict Management, Security and Economic Cooperation in Central Asia" in the Institute of Political Science, University of Giessen and edited by Professors Drs. Seidelman R. and Giese E. on "*Cooperation and Conflict Management in*

Central Asia, Zentrum fuer Internationale and Umweltforschungspolitik. Justug Liebig Universitaet, Frankfurt-am-Main, Peter Lang Verlag, Band 10, 2004". Based on the materials of the similar international conference in Germany May 2003, the book contains interesting contributions both, from local experts in Central Asia as well as from those outside the region. This kind of editions are valuable first and foremost for exchange of views between local and foreign scholars, which leads to better understanding of features and the substance of challenges in Central Asia, and helps develop adequate policy strategies for their resolution. In addition, they may also be of wider public interest to those feeling a shortage of knowledge about the so far untapped region.

A number of articles published in foreign literature are also of particular significance. For instance, "*International Affairs*" Magazine, 2004, Vol.80., issue 3 contains a set of analytical articles on regionalism in Central Asia, as well as on an Interstate Cooperation between the regional states within the CIS and the Shanghai Forum.

Reports and data from international institutions, such as the United Nations Organization, World Bank, International Monetary Fund, European Bank on Reconstruction and Development, Organization for Economic Cooperation and Development, Asian Development Bank, World Energy Organization and some others have been of particular assistance in maintaining the research with empirical and statistical data. For instance, being one of the largest multilateral investors in Central Asia, ADB in addition launched and is currently coordinating a special programme "CAREC" (<http://adb.org/CAREC/default.asp>) for the support and expansion of regional projects in trade, energy and transport and infrastructure, to enhance better cooperation throughout the region.

Finally, daily developments throughout the region have been monitored. Such information could be available through a number of information web sites for each of the countries and for the region as a whole. For Uzbekistan, it is the *National Information Agency Uza* (www.uza.uz), for Kazakhstan - www.kazakhstanoday.kz, for Tadjikistan - *National Information Agency* (www.asiaplus.tj) and for Kyrgyzstan- the *National Information Agency Kabar* (www.kabar.kg). Regional reports and analytical articles are also available on *the Times of Central Asia* on-line newspaper (www.times.kg) and on the NGO info forum EurasiaNet operated by the Central Eurasia Project of the Open Society Institute (www.eurasianet.org).

Chapter II. THE ESSENCE AND PRIORITIES OF ECONOMIC REFORMS IN UZBEKISTAN IN THE YEARS OF INDEPENDENCE

2.1. Uzbekistan under the Plan System: Process and Consequences

Historically the inhabitants of Central Asia were divided into the nomadic (Kazakhs and Kyrgyz) and sedentary (Uzbeks, Tadjiks and Turkmens) societies. While Europe faced industrial revolution, in Central Asia people were engaged into the labor-intensive agrarian sector, pre-dominantly in land cultivation and cattle-farming. When the Russian empire came to the region in the 19th century, it sought additional sources for keeping up its manufacturing and industrial boost. Following this logic the new lands were thus exposed to extensive military and economic conquest by the Tsarism which culminated in the establishment of the Russian protectorate in the region.⁹

After the overthrow of the Russian monarch family by the Bolsheviks in October 1917, the new Soviet government went even further trying to bring Central Asian economic, social and spiritual values in compliance with the other parts of a new Soviet state. The idea of transition from “feudalism” directly to “socialism” in Central Asia presented by communists aimed, among others, at overcoming tribal and feudal relations.¹⁰ But there was a strong conviction that this was not just a “break-through” from feudalism to socialism, but the enhancement of the acceleration-based development to embrace gradual industrial transformation and equalization of the development level with other parts of the Union. The given process of integration of the new territories into the common Soviet economic system did not occur smoothly, both due to the shortcomings to be intrinsic to the plan system and subsequent socio-political and economic developments in Uzbekistan.

By substance, the Soviet methods of management in the plan system was to provide a strong control over political and economic processes on the macro- and microlevels through the tough directives on consumption, distribution, and production of material wealth. And what’s more, the economic power of the Center was based on the monopolist power of state property on land, mineral base, the means of production. The main point was that public property meant state property which was controlled by a narrow number of people related to the power (nomenklatura, partocratia, socio-oligarkhia). Market mechanisms were absent. The production process was separated from financial flows. Money did not carry all its functions as in a market economy. They just played the role of a unit of accounting transfers from one

⁹ See more in Inomjonov Kh. “Aussen und Sicherheitspolitik der Republik Usbekistan in den ersten Jahren der staatlichen Unabhaengigkeit“ within the Central Asian project.

¹⁰ Tukhliyev N., Taksanov A. Natsionalnaya ekonomicheskaya model Uzbekistana. Tashkent. 2000, p.28

branch or enterprise to others according to the decisions made at the center, with only a minor influence by production units. This drove factory managers to circumvent plans or seek devious ways of fulfilling them in order to accommodate the special problems they faced in their production units. Among the most common have been falsifications of production statistics, illegal transfer of funds from one use to another, and the concealment of full production capacity from the superiors. Another frequent practice was to take advantage of the way in which plan targets were stated to fulfil the plans in the easiest manner possible, regardless of the needs of the economy. And what is more interesting is that the Soviet political leadership not only realized the substance of the problem even in the early 1960s, a quarter of a decade before the cordial changes in the domestic political and economic life, supposed by perestroika, but also undertook reform efforts in 1965 to give the enterprises more autonomy in exchange for increased efficiency.¹¹

The particularity of the plan system was a strong fusion of economic and political power where the latter prevailed and therefore, controlled everything and everywhere. Its “brain” was the Communist Party which managed the state and the economy, and whose tentacles reached every corner of organised social life in each republic. Production, supply and redistribution of raw materials as well as budget transfers and resource allocation were fulfilled exclusively by Moscow. To become a manager of an enterprise, one was strongly required to go through the Communist Party’s system and earn the confidence of the partocrata. To make any settlements at the local (regional) level, for instance, between Ferghana and Tashkent, enterprises should have got permissions from the Union ministries and state organs which were located in Moscow. It required much time and complicated paper procedures, although this also could not be enough to eventually obtain needed decision. *“The political side of the question is that any attempts of the republics to find new, more acceptable ways and forms of development had been considered as “nationalism” and therefore, been strictly restricted”*.¹²

The industrial development in Uzbekistan after joining the USSR could bring forward a number of questions the main of which are: how and why was “industrialization” pursued;

¹¹ For instance, some authors refer to the production of various manufacturing products to demonstrate low efficiency in the Soviet economy. For example, the producers of furniture, for example had plans stated in roubles. Hence they found it best to make massive furniture since the heavier the products the more expensive they were. Then the plan was formally met as the furniture makers added various details to the products in order to make them more expensive rather than more suitable and competitive. As a result, the production represented highly cost consuming process leading to the depletion of funds and over-consumption of resources. And this was evoking significant problems across the general sectors of economy and particular industries, such as agriculture, energy complex, etc. For more information on the deficiencies in the Soviet economy see: Barry. D.D., Barner-Barry C. Contemporary Soviet Politics. An Introduction. New Jersey, Fourth Edition, 1991.pp.174-192.

¹² Translated by the author from Karimov I. (1993) O’zbekiston – bozor iqtisodiyotiga o’tishning o’ziga hos yoli. The collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.81.

and to what extent did Uzbekistan benefit from such “industrialization”, i.e. to what consequences did it lead?

During the Soviet rule Tashkent, an Uzbek capital, in fact became the fourth largest city in the Union and also served as the center of gravitation to many other Central Asian industries. Equally, however, the policy encouraged further interdependence of the regional republics with the European parts, paying less attention to the reinforcement of intra-regional relations. Consequently the Soviet republics were strongly connected to each other via interrelated links in production and distribution of material wealth, especially on the basis of material balances consisting of a number of strategic commodities and inputs such as coal, gas, oil, means of production and etc. which subsequently had an impact on the volume and structure of production.

In this respect, Uzbekistan had specialised in production of raw cotton. The country was the 4th largest country in the world by production of cotton and the 2nd one – by its export. By 1990, Uzbekistan produced 62,4% of cotton-fiber of the whole USSR and cotton ginning was a fifth of its total industrial growth. During the development of the republic the volumes of production were increased primarily through the expansion of cultivated areas, but not through better agricultural productivity (which was the lowest in the economy – 1% per worker in 1970). If during the years of five-year-plans (1961-1965) the republic harvested about 3,484 mln. tons of raw cotton, then in 1966-1970’s period the state order forced to yield 4,100 mln.tons per year.¹³ Subsequently, in the 1980’s the plan targets were further tightened demanding about 6 mln.tons, the yet ever highest figure (Table 2.1).

Table 2.1. Average Annual Cotton Production in Central Asia

	Thousand tonnes		Yield per hectare (centners)	
	1976-80	1981-85	1976-80	1981-85
Uzbekistan	5704	5724	31.3	29.7
Kazakhstan	317	302	27	23.3
Kirgizstan	208	87	28.3	19.1
Tadjikistan	906	917	30.7	29.8
Turkmenistan	1143	1210	22.7	22.7

Source: McCauley M. Agriculture in Central Asia. p.95

Under such conditions the system of economic relations was driven with the administrative methods of control and orders with accordingly little attention to its socio-economic consequences. In particular, the labor of school-goers and students was also widely used.

¹³ Uzbekistan za Godi Vosmoy Pyatiletki (1966-1970). Central Committee of the CP UzSSR. Tashkent. 1971

They were sent to the rural regions of the republic each autumn and had been staying there for at least two months in rather severe living and climatic conditions. In Uzbekistan, in 1978, the number of adults and schoolchildren sent to bring in the cotton crop reached 2 mln, and only 28% of the total crop was mechanically picked in 1985. Although the Central Committee of the Communist Party of Uzbekistan condemned such practices during the bringing in of the 1986 crop, local government organs continued violations of the established time limits for schoolchildren and students to spend on agricultural work and did not create normal conditions for their work and living.¹⁴

It is difficult to estimate whether net social and economic losses were exceeded by benefits calculated in physical volumes of the picked cotton. Yet such losses were also characterized by the involvement of high skilled labor from other non-agrarian spheres which therefore did not produce good and services they ought to do. There was also no estimates on social effects from emergency situations caused by the deterioration of health among population, especially among school-goers and students. There were regular reports on the year-on-year growth of the harvest and low production costs, but which had consciously hidden or ignored the facts of using cheap and abundantly available child labor. Moreover, the question is still open to debate whether those figures (6 mln.tons of cotton per year) would have been ever attainable even with full economic capacities having been involved into operation. The more evident fact is that for the fear of tough punishment, local production entities and statistical organs started counterfeiting the figures with an even more distortive and damaging impact on not only the plan economy as a whole, but on the local spheres of production too. Such distortions could be then barely overcome by the administrative methods of the Center.

As was evident from the words of the President of Uzbekistan Islam Karimov too: *“Due to the conservative administrative system, party management over the economy and extremely ideologization of the latter, all further efforts on economic reforms (the 1979 Planning system reform, the 1987 reform of an economic mechanism) had brought little results”*.¹⁵

Moreover, environmental conditions were not taken into consideration at all and resulted in dramatic consequences. The area under irrigation increased up to 5-5.5 mln.hectares in the 1980s, which amounted roughly a half of irrigated lands in the whole region. As a result,

¹⁴ There is an opinion that in order to offset the declining size and quality of the crop throughout the 1980s, farms resorted more and more to manual labor, while economic viability of using either labor force or cotton-picking machines remained opened and differed across the republic and even the farms. See: McCauley M. Agriculture in Central Asia. In Akiner Sh. (ed.) Political and Economic Trends in Central Asia, British Academic Press, London-New York, 1994, pp.96-97.

¹⁵ Translated by the author from Karimov I. (1993) O'zbekiston – bozor iqtisodiyotiga o'tishning o'ziga hos yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.76.

according to some sources, of the two rivers' (Amudarya and Syrdarya) total average annual runoff of 115 km³, about half reached the Aral sea in the years before 1960, which kept the lake size stable, but between 1981 and 1985 an average of only 5,2 km³ reached the Sea and practically no water reached the lake in 1986.¹⁶ Without appropriate recovery of lands between harvests, they (lands) faced a huge number of injections of chemical fertilizers. The ensuing problems of salinization, toxic dust storms and climatic change were causing serious deterioration of health standards by the 1980s. Since then on, Uzbekistan is still reaping the results of distortion in environment conditions (shrinking of the Aral sea) directly reflected in worsening state of health and the standard of living of population in a number of regions of the republic.

Since the 1930s Uzbekistan had been experiencing quite rapid economic growth maintained by industrial expansion, especially high on the initial stages and then resuming in the aftermath of the Second World War (Table 2.2). For the Soviet Union the political significance of this process followed the two main goals. On the one hand, it could be an attempt of some kind of illustration on the international arena of what could be achieved by following the socialist path of development. Yet its domestic impact was much more important. Reflecting the policy of nationalities declared by J.Stalin in the 1930s, it aimed at economic and cultural parity among the nations of the Soviet Union and which was eventually believed to be accomplished with success by 1980s.¹⁷

Table 2.2 Uzbekistan's Annual Average Industrial Growth Rate, %

1929-32	11.7	1946-50	11.3	1966-70	6.3
1933-37	19.4	1951-55	10.1	1971-75	8.6
1938-40	9.5	1956-60	7.4	1976-80	5
1941-45	1.3	1961-65	8.4	1981-85	3

Source: Thompstone S. Uzbekistan's economic Prospects, p.103.

However, the industrial sector was distorted and production process was technically inefficient. Most of the output consisted either raw materials or intermediate goods supplied to the USSR's market. The production of agricultural machines and equipment, for example, primarily had to meet the domestic and regional needs, while aircraft plant, fuel and energy complex and mining were linked to a number of respective industries in non-regional republics. The efficiency of factories in Uzbekistan's smaller population centres was in

¹⁶ Pomfret R. (1996) Asian Economies in Transition: Reforming Centrally Planned Economies. Cheltenham, UK. p.101

¹⁷ Thompstone S. Uzbekistan's economic Prospects, in Akiner Sh. (ed.) Political and Economic Trends in Central Asia, British Academic Press, London-New York, pp.104-105.

general significantly below that of industrial enterprises in the larger cities. In 1985 it was reported that the returns on assets and labor productivity in the domestic industrial sector were continuing to fall. At the beginning of 1986 the 21st Congress of the CPU heard that the return on investment in the republic had declined by a third over the past ten years. As a result, average annual growth rate of Net Material Product, i.e. GDP had been on a downward trend, decreasing from 6.5% in the period of 1960-65 to only 4.4% and less after 1980. In so far as NMP per capita reflects living standards too, in terms of high population growth rates, this indicator also experienced decline from 3% per capita in 1960s, 2.2% in 1970 to virtual stagnation (0.3%) in the 1980s.¹⁸

The Soviet industrial policies in Uzbekistan could be intrinsically highlighted with the following features:

1. Through its monopolist power in the whole economy, the state increased its influence in industry. There were 3 types of enterprises in Uzbekistan: those submitted to the Center (the all-Union submission); those submitted to the local authorities; and their combination. The proportion of enterprises regulated by the Center, and the mixed administration was increasing and amounted to 74,6% and 92%, respectively. By having such a lever, Moscow eventually could determine the main indicators, such as the volume and assortment of products produced, dislocation of labor, structural policy, labor relations (staff training, labor migration), etc.
2. The Center used such mechanisms which integrated the republic into the Union's division of labor with the narrow specialization, and the uneven and irregular structure of industries. For instance, at the end of the 1980s, the proportion of machine-building in Uzbekistan in total industrial output was equal to 16%, while manufacturing – 13,8%, light industry – 37%. Production of consumer goods per capita did not exceed 40% of the union's average level. On the whole, more than 60% of total industrial production was at the expense of non-labor-intensive production which produced raw materials and intermediate products.¹⁹
3. Industrial policy reinforced differences in industrial development between the regions within the republic. For example, such an approach resulted in situation when 5% of the

¹⁸ Thompstone S. Uzbekistan's economic Prospects, in Akiner Sh. (ed.) Political and Economic Trends in Central Asia, British Academic Press, London-New York, 1994, pp.103-104.

¹⁹ Tukhliyev N., Taksanov A. Natsionalnaya ekonomicheskaya model Uzbekistana. Tashkent. 2000, p.30

republican territory had covered 65% of total industrial potential (enterprises) of Uzbekistan. Tashkent and the Tashkent region hosted half of those enterprises.²⁰

4. The development of traditional branches of the economy, such as the cooperatives and cottage and handicraft workshops, was restrained. According to the data of 1989, cooperatives included 24,8 thousand of workers, cottage workshops – 15 thousand which accounted for only 0,52% of all population engaged in the economy.²¹

5. The policy of the Center was intended to keep up an agricultural structure in the economy due to the availability of natural and production factors (geographic conditions, labor force), while industrial base was confined to extracting and initial manufacturing.

By the early 1990s, the image of the Uzbek economy had been formed to associate basically with the minerals and agricultural products. During the Soviet time it was the 2nd largest producer of gold by total production (following Russia) and 1st one – by per capita production. Besides, Uzbekistan produced (as a ratio of the Union production) in agriculture: 65% of cocoons, 40% karakul, 15% food oil, 2% meat, vegetables and fruits; in industry: 6,9% silk and 6 cotton fabrics, 5,6% chemical fibre, 5,6% fertilizers, 5,2% knitted wear; 4,7% construction bricks, 4,7% cement; 3,7% chemical equipment, 3,6% agro machinery, 2,4% excavators, 1,16% engines; 3,1% refrigerators, 2,7% furniture; 3,3% electricity.²² Since many of finished goods were by and large in shortage in local countries' markets, in terms of inter-republican trade all the republics recorded sustainable trade deficit (See Annex 2.1, Table (a)).²³

Although agriculture contributed much to domestic national income, it also was the largest sector by the number of unemployed among all countries of the region.²⁴ The Soviet policy with respect to the Central Asian states proceeded from the priority to produce a variable number of raw materials and to supply them to industrial plants in the European parts of the Union, representing the continued colonial nature of Uzbekistan's relationship with other

²⁰ The same.

²¹ Natsionalnaya Ekonomika Uzbekskoy SSR. 1990. Tashkent, 1991

²² Tukhliyev N., Taksanov A. Natsionalnaya ekonomicheskaya model Uzbekistana. Tashkent. 2000, p.31.

²³ General analysis of Central Asia's place in total Soviet output shows that contribution to Soviet agriculture was equal to more than 17%, ranging from minimum 10% (milk production) to maximum over 20% (fruits and vegetables, half of which came from Uzbekistan). Extractive industries produced about 17% of all Soviet natural gas, about 20% of total coal, as well as 8% of furniture, 15% of knitted wear, about 14% of shoes in 1990. At the meantime, durable goods, such as home appliances, transport means, were extensively imported from other republics. The absolute values of inter-republican trade, however, should be seen cautiously, since in terms of distorted prices on different goods and inadequate exchange rates in the USSR, it is difficult to reveal true figures on the values of trade between the republics. For all this see the Tables in Mangott G. (Hrsg.) Buerden Auferlegter Unabhaengigkeit. Neue-Staaten im post-sowjetischen Zentralasien, Oesterreichisches Institut fuer Internationale Politik, Laxenburger Internationale Studien, LIS 10, Wien, 1996., pp.151-158.

²⁴ According to the estimates, in 1979 state and collective farms in the republic had a manpower surplus of nearly 240000, while unemployment had already reached 2 mln. in the first half of the 1980s. See: Thompstone S. Uzbekistan's economic Prospects, in Akiner Sh. (ed.) Political and Economic Trends in Central Asia, p.108.

republics. For example, in 1980 only 7% of cotton was manufactured in the republic while the rest part was exported to other republics, primarily to Russia, Belorussia, and Ukraine.²⁵

The Soviets were understandably loath to allow the control of the spheres which could potentially provide the economic sovereignty of the republic. Hence, the most developed industrial branches were controlled by the all-Union Ministries in Moscow. The preliminary processing of raw materials produced was carried out in the republic, while more complex manufacturing and production of goods took place in other republics of the Union.²⁶ These raw materials were as a rule underpriced in the USSR, which led national industry to contribute little to local national income.²⁷ For instance, for the years, the specialization of Uzbekistan with respect to agriculture became more evident. If in 1970s the Uzbek industrial output was about 68% of local national income, agriculture – 22%, transport and communications – 3,2%, the rest – trade and others²⁸, in 1990 industry – 25,7%, agriculture – 44,2%, construction – 14,1%, transport and communications – 4,7%, others – 11,1%. While the average Union indicators at that time were amount to 40,4%, 24,8%, 12%, 6,5% and 16,1% of national income of the USSR.²⁹

*“Neither transport costs, nor other relative costs were taken into consideration that was negatively influencing on regional development of any republic. On the other hand, the goal was to make the republics closely interdependent on each other which, in our opinion, may reflect immediate development and consequence of imperialistic policy”.*³⁰

Another peculiarity is that all Central Asian states were the closed economies, with trade primarily inside the USSR (See Annex 2.1, Table (b)). It means that much of Uzbekistan’s needs in inputs and consumer goods was related to the centralized decisions taken in Moscow on all trade flows to and out the republic. In addition, geographical disadvantages of the country were exacerbated by a transport system oriented towards the north (Russia and the European parts of the USSR) and with little or even no links to the south. It is difficult to say,

²⁵ Thompstone S. Uzbekistan’s economic Prospects, in Akiner Sh. (ed.) Political and Economic Trends in Central Asia, British Academic Press, London-New York, 1994, p.111.

²⁶ For example, raw cotton was supplied to textile works in Russia and the Baltic to produce clothing and other textile products which were subsequently sold to other republics, including Uzbekistan itself.

²⁷ For lack of data, it was practically impossible to calculate acute economic figures reflecting benefits and losses of such policy. Some authors believe that many Central Asian states were subsidized, mainly either financially or through import supplies of goods and services. For example, one seventh of GDP in Kyrgyzstan was provided by import supplies from other republics. Yet local scholars stand by the view that underpricing of locally extracted resources, mainly minerals and energy was exceeding the aforementioned benefits. See: Pomfret R. Central Asia since 1991 ; the Experience of the NIS. OECD Development Centre Technical Paper 212, Paris, July 2003.

²⁸ Uzbekistan za Godi Vosmoy Pyatiletki (1966-1970). Central Committee of the CP UzSSR. Tashkent. 1971

²⁹ Natsionalnaya Ekonomika Uzbekskoy SSR. 1990. Tashkent, 1991

³⁰ Our translation from Karimov I. (1993) O’zbekiston – bozor iqtisodiyotiga o’tishning o’ziga hos yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.81.

whether infrastructure development would have taken place, if no Soviet military intervention in Afghanistan in 1979 had been decided. Central Asia strengthened its position in the Soviet system, because during this war the region was politically considered as a strategic hinterland. This policy brought to Uzbekistan electrification and the establishment of good road network along the Afghan border, and also subsidies in energy and money.

The developments in the social sphere are also of specific attention. With significant transfers from Moscow (in the 1970s about 47% of all expenditures of Uzbekistan on social and cultural events in the economy were from the USSR's budget), the republic yet plunged into a number of social problems. The population was not provided enough with housing, healthcare services, and so on.³¹ Basic social security here had long been inferior to the rest of the USSR. The entire region was at the bottom on a number of indicators, such as the number of inhabitants per doctor, dispensary and sanatorium.

Due to the backward development, within the region Uzbekistan and Tadjikistan were the most dependent on the Central Union budgetary transfers. If during the 1960s Uzbekistan obtained about 15% of its revenues from Moscow, in 1970 – 20%, then in the 1990s the figure amounted to 42,9% of all revenues of the republican budget.³² Later on, there was an abrupt drop in the whole Central Asia's investments coming from the Centre: per capita investments were two thirds less than in the rest of the USSR.³³

Despite the fact that approximately half (47%) of the republican expenditures were directed into the social sphere of the economy, they lagged behind corresponding all-union indicators (Table 2.3).

The aforementioned was corroborated by the pressure of complex demographic situation in the republic. For example, in the 1979 census almost all the Central Asian nationalities had large families - the average Uzbek family consisted of 6.2 children under eighteen while the Russians had only 3.16 and the Latvian 3.0 under the average Union number was equal to

³¹ Shortage of housing was critical in the republic, compounding urbanization and job creation. If employment opportunities could have been created in the urban areas to absorb the growing manpower surpluses of the countryside, the urban housing stock surely could not. Only to keep pace with the anticipated population growth in the 1980s, it would have needed 2.5 times more housing in the next 15 years than in the previous three five year plans. The pressure of urbanization would have then increased this figure markedly. Thompstone S. Uzbekistan's economic Prospects, in Akiner Sh. (ed.) Political and Economic Trends in Central Asia, British Academic Press, London-New York, 1994, p.111.

³² Uzbekistan za Godi Vosmoy Pyatiletki (1966-1970). Central Committee of the CP UzSSR. Tashkent. 1971, p.14; World Bank (1992). Statistical Handbook: States of the Former USSR. (Washington. D.C.)

³³ Olivier R. (2000) The New Central Asia. The Creation of Nations. New York University Press, New York. p.127

3,5.³⁴ By the early 1990s the natural growth of population had reached 27,6 which was 4 times higher than on average in the USSR.³⁵

Table 2.3 Comparative data on volume of services per capita, 1990
(in Soviet roubles)

	Social services	Transport	Communi-cations	Housing	Culture	Tourist	Sport	Recreation
USSR	56,9	68	15,2	42,4	8,9	13	0,9	7,8
Uzbekistan	40,2	39,8	5,6	21,3	4,2	6,4	0,4	2,2

Source: The National Economy of the Uzbek SSR. 1990. Tashkent, 1991

The population growth in the republic could be explained by both internal and external reasons. As an internal one, they were Uzbek traditional values and Islam both of which were encouraging long families. Partly because of it, in rural areas where the majority of population were of local nationalities, the population growth was always higher than in regions with non-indigenous population, like in the capital Tashkent, for example. Being an external factor, the Soviet demographic policy saw population growth as the main labor source for its military and production needs. The essence of the policy was to encourage high population growth rates in Central Asia to offset relatively poor growth rates of population in the European parts of the USSR, as well as maintain labor-intensive needs in the local agricultural sector.³⁶

The level of urbanization as a sign of the Soviet efforts on industrialization and elimination intra-union regional differences showed that these differences were remaining. The European and Baltic republics were all over two-thirds urban, whereas the Central Asian republics were largely rural and agricultural.³⁷ For example, during the period 1970-1987, urban population

³⁴ Lane D. *Soviet Society Under Perestroika*, London and New York, Revised Edition, 1992, p. 194

³⁵ Tukhliyev N., Taksanov A. *Natsionalnaya ekonomicheskaya model Uzbekistana*. Tashkent. 2000.

³⁶ In addition, the rapid growth of population in all Central Asian republics observed since the end of 1950s was explained by a favorable correlation between the indicators of birth and mortality, while the influx of population from outside had been relatively small. Mortality rates were mainly reduced due to successful measures in public health care and the less consequences of the World War II for local peoples than for other republics. For more information on demographic trends in the region see Kozlov V. *Ethnographic Problems of Central Asia and Measures for Their Solution*, In Akiner Sh. (ed.) *Political and Economic Trends in Central Asia*, British Academic Press, London-New York, 1994, pp.143-152.

³⁷ The Soviet Union's rural population declined by some 10 mln. Between 1959 and 1989, while the population in Central Asia increased by 78 mln. Yet in Central Asia (including Kazakhstan) between 1959 and 1978 the rural population rose from 14 mln. to 25 mln. representing a 75% growth, mainly due to higher birth rate of the indigenous population in rural areas. See: Lane D. *Soviet Society Under Perestroika*, London and New York, Revised Edition, 1992, p.193

increased in Uzbekistan from 37% to 42%, while in Russia – from 62% to 74%, Belorussia from 43% to 64%, Armenia – from 59% to 68%, Lithuania from 50% to 67%.³⁸

High demographic growth in terms of non-adequate increase in national income and incapability to create jobs further contributed to the deterioration of socio-economic life in Uzbekistan. There were two possible solutions to cushion the situation: either to develop local industry and agriculture, or to make the extra workforce more mobile outside the region at all. Inasmuch it was practically absurd idea to suggest Central Asian people jobs in severe Siberian climatic conditions, the republic was doomed to be under the pressure of imbalance on the domestic labor market, especially among rural population. Moreover, along with the whole republican deterioration, a sharp intra-regional disproportions like expanding differences between urban and rural areas were also observed. Most part of national communities lived in rural areas and engaged in agriculture.³⁹ In terms of huge labor force and low productive efficiency in agriculture, the local population had relatively low income.

As regard the standard of life, one needs to be cautious, since it was always hardly exposed to quantitative estimates. In addition, in the USSR the Soviet methodology was strongly distorted for political reasons to hide poverty and low standards of living. This may explain the variance of figures found in literature. For instance, according to existing estimates, the UNO evaluated that about 40% of all population of Uzbekistan lived below the poverty line (i.e. below the minimum wage level) in last years of the USSR. However, the figure did not reflect access to free education, public healthcare, a number of privileges for people with low-income that certainly could make the poverty size lower than it might actually be.⁴⁰ Other estimates say that in 1991 about 75% of population had per capita income lower the value of consumer basket (of main vital foodstuff and consumer goods) in comparison with the European part of the USSR (Russia and Ukraine) where the figure was equal to 30%.⁴¹

Hence, some important conclusions could be set out. Before October Revolution in 1917 in Russia industrial development had hardly begun in Soviet Central Asia in its true way. Bolsheviks managed to some extent to equalize standards between the regions due to industrial growth especially strong in Kazakhstan (8.5 times) and Kyrgyzstan (8.3) during 1913-1936. Some scholars even noted that being on par with (or below) countries like India,

³⁸ Source is the same. See Table 6.3 on p. 194.

³⁹ More than 80% of rural population were Uzbeks, while constituting only 36% and 25.3% of labor force in industry and construction complex respectively. Thompson S. Uzbekistan's economic Prospects, in Akiner Sh. (ed.) Political and Economic Trends in Central Asia, British Academic Press, London-New York, 1994, p.106.

⁴⁰ UNO (2001). Uzbekistan: Obshaya Otsenka Strany. p.15

⁴¹ UNDP (1999). Uzbekistan. Human Development Report. p.32

Iran and Pakistan in 1926, by the early 1960s the Central Asian republics were similar to countries like Italy so far as economic development and cultural and welfare facilities were concerned, as the region has been transformed from a stagnant, illiterate, disease-ridden, semi-feudal society into a modern progress-oriented society.⁴² Yet such industrial growth was not difficult due to a low level of the domestic industrial level. Moreover, due to inadequate prices which were disintegrated from the real costs of inputs, environmental externalities, low labor costs, etc. the consequences of this process in terms of its positive impact may with little doubt look much more moderate.

Thus by 1988, the local economy had faced relatively high growth of GDP (5,2-5,3%), remarkable growth of industrial output (5-5,8%), sustainable growth of agricultural production. During this period a number of fundamental industries were both founded and got a strong push to develop (machine-building, chemical industry, metallurgy, and oil and energy complex).⁴³

In the years of perestroika domestic economic life was deteriorating as a result of the turn in Soviet policy priorities. Relatively to Central Asia, it envisaged primarily the decrease of subsidies, prosecution in the economic field, etc., which then led to the deterioration of political credibility of local elite before the Center. Socio-political crisis was exacerbated by natural economic stagnation through the gradual depletion of opportunities and capacities of the plan system. Economic growth was decreasing from year to year (1,6% in GDP and 2,8% in industrial output in 1989-1991). Moreover, in terms of relatively high population and labor force growth it resulted in decline of productive efficiency in the economy as a whole.

*“For a few decades, Uzbekistan has transformed into integral part of common economic complex managed by the Center. Hence, like in the years of the Tsar Empire, the republic represented both a supplier of cheap and strategic mineral resources, and a favourable market which was absorbing (imported) ready products. The decisions taken by the Center were not in compliance with the interests of Uzbekistan”.*⁴⁴

Eventually by 1990s Uzbekistan had come to have a one-sided distorted economy with prevailing cotton output in agriculture and low-level industrialization; with primarily extensive methods of production; with tough direct control over the economy, and bureaucracy; with a high level of hidden unemployment (according to some estimates, about

⁴² Lane D. Soviet Society Under Perestroika, London and New York, Revised Edition, 1992. Quoted from Charles K. Wilber (1969). p. 197

⁴³ Chepel S. (1996) Makroekonomicheskiye problemy perehodnogo perioda. Tashkent

⁴⁴ Our translation from Karimov I. (1993) O'zbekiston – bozor iqtisodiyotiga o'tishning o'ziga hos yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.79.

20%⁴⁵), and therefore, with the high level of misery. In other words, the bottom of the problems in Uzbekistan in the early 1990s went back to the past, calling for the necessity of urgent macroeconomic reforms. The implementation of this task, however, was due to take place already in new time and under new conditions caused by the collapse of the USSR.

2.2. The Transformation Process and its Outcome in the Last Decade

2.2.1. The Choice of Further Development Strategy: Possibilities and Contradictions.

The Essence of the “Uzbek Economic Model”

*“Without a comprehensive analysis of the existing situation, [and of] the reasons for deep economic, social and political crisis, without determination of the negative elements in the economic system which have to be eliminated before the reforms are launched, it is impossible to transform the society into its qualitatively new form”.*⁴⁶

After the general crisis of the socialist system the former Soviet republics entered the new phase of its historical development. Under particular circumstances, each country definitely declared to build up a market economy and democratic society. Since that, there have been a wide range of discussions on economic reform strategies and on the choices of the most optimal model of transition to market. However, the final aims have proved to be much more complicated to achieve than it was expected. Today, even more than a decade later, it is clear that it may take a few decades to reach that level of the majority of industrially developed countries. Moreover, each country in transition succeeded to a different degree in the socio-political and economic reforms. Some of them managed to be relatively more successful, while others are still facing various setbacks. Most part of these differences was initially explained by the speed and coverage of reforms at the very beginning. To some extent, initial conditions could be important to explain these trends. Comparatively advanced position of the Eastern European states in the early 1990s was seen as a pre-requisite for making successful transition to a market economy. This point is related to a number of factors. Firstly, Eastern European countries had a huge industrial potential which could develop as soon as it would be given necessary stimulus by the government. Secondly, a degree of centralization was lower than in the USSR, and, therefore, enterprises had more freedom to make business. Thirdly, private sector was relatively independent and had more opportunities for the development than economic units in the Soviet regime. Finally, East Europe was closer to the West

⁴⁵ Tukhliyev N., Taksanov A. Natsionalnaya ekonomicheskaya model Uzbekistana. Tashkent. 2000, p.68

⁴⁶ Our translation from Karimov I. (1993) O'zbekiston – bozor iqtisodiyotiga o'tishning o'ziga hos yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.75.

geographically, that allowed for the development of social-political and cultural relations under the indirect influence of the Western democracies.⁴⁷

*“In terms of the collapse of the totalitarian system and the emergence of new independent states on the basis of former Soviet republics, it becomes very important to develop and justify new approaches on economic construction and further transformation. Declaration of independence for each of these republics implies their intentions to pursue domestic and foreign policies in accordance with their national interests”.*⁴⁸

The post-Soviet states were in worse conditions to start with economic reforms. The crisis in the USSR was exacerbated in the early 1970s and became more evident by the 1990s. It manifested widely through chronic stagnation, state budget imbalances, hidden inflation, low investment activities in the economy, and deteriorating socio-economic situation.

In this respect, the backwardness and dependency of the Central Asian region on the Center undoubtedly ought to influence the development of market reforms there. In comparison with other countries of the region, Uzbekistan found itself in situation which had significantly determined the strategy of further development. The positive and negative aspect of the republic's conditions are summarized in Annex 2.2.

Social situation in the country was especially fragile with:

- a substantial decline in the standard of living of local population because of an abrupt decrease in real wages, social insurance and pensions;
- growing income differentials and unemployment rate;
- the risks of social destabilisation due to the growth of criminality, drugs business, terrorism, extremism, bribery among government officials.

For the official economic policy those were among the key arguments to deny big bag changes in the economy in favor of the step-by-step reforms. Firstly, there was a perception that such reforms might result in increasing social instability if radical price liberalisation and structural changes would be implemented. It might in turn provoke further growth of unemployment and income differentiation in the society most part of which consisted of “vulnerable groups” (old-age people, both long and poor families, and the young population under age 15). The government thus refused such changes in the economy in the early 1990s in favor of retaining stability in the society.

⁴⁷ Smith A. Eastern European Economies, in Eastern Europe and the CIS, Paris, OECD, 1999. p.62-73.

⁴⁸ Translated by the author from Karimov I. (1993) O'zbekiston – bozor iqtisodiyotiga o'tishning o'ziga hos yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.71.

The second explanation of the strategy of Uzbekistan lied in the simple absence of necessary government institutions in the republic right after the independence through which one could be possible to carry out the aforementioned changes. A number of the existing institutions had to comply with the conditions set up by the previous plan system, through mainly prioritization of vertical relations, but without not the less important inter-institutional collaboration. In addition, these institutions felt a huge lack of knowledge and expertise on a market economics to keep pace with the substance of the reforms pursued.⁴⁹

The domestic situation was also exacerbated by a number of ideological factors. As a result of the collapse of the former communist ideology, an ideological vacuum was increasing. On the other hand, the socio-psychological way of thinking of the past was strongly entrenched in society. In particular, the firm Soviet ideology on "equality" and "social justice" in public minds was tantamount to the enhancement of negative attitude to private property, and therefore, weakening private initiatives. On the contrary, the monopoly dominance of state were strongly required. The strong dependence of Uzbekistan on the Center budget transfers only even strengthened further dependence of the republic on Moscow, and that of local population - on social benefits. In such situation, a number of destructive ideologies under the cover of religious values started to spread across the country. It was evident that the necessity of urgent domestic stabilisation, retention of the existed institutional network to deal with economic and social problems as well as countermeasures to the proliferation of destructive ideologies should make up the core of the multi-edged top national priorities in the early 1990s. As a next step, the idea of democratic society with steady industrialization and market reforms towards better living standards was regarded.⁵⁰

⁴⁹ For example, only a handful of people worked in the Ministry of Foreign Affairs in Soviet Uzbekistan, while the existing Uzintorg (the responsible institution for foreign trade) was forced to act completely within the directives of the monopolist Moscow-based foreign economic agency. Thus both time and specific reforms would be required for local elite and institutions to learn and adequately perform their functions in new conditions of open international relations.

⁵⁰ International experience suggested a few possible choices. The Turkish model with a pro-western secular state was favored by Turkey which was one of the first states to recognize the independence of Uzbekistan. It had very ambitious goals with respect to the region that was partly explained by their historical and cultural relations. Turkish investors were one of the largest ones in the early 1990s. The Iranian model of Islamic fundamentalism and theocratic state with huge influence of the religion on state affairs was hardly acceptable due to the dominating ideas of a secular state and society. The Pakistani model was more secular, but Islamic religion had strong roots in the society, with a particular emphasis on fundamentalist religious values. The Chinese model with authoritarian and socialist mixture in the control over the economy was lucrative due to similarities of the past and the precedent of the successful moves towards market reforms even in terms of the administratively led policies. Finally, the New Industrial Countries (NIC) model of small East Asian economies with an open-type economic sector and very often a leading state role was attractive because of impressive economic growth performance in the recent decades. Although the models were different by substance and nature of socio-political and economic development of the countries, they also had some similarities. The geographical location in Asia (even partly for Turkey); the Oriental societies with sustainable traditions in which collective values are prevailing over private; the superiority of the power and government could be of much interest for Uzbekistan on

Further steps were undertaken to minimize a negative impact of the socio-political and economic processes which were taking place in other republics on local development, and to reduce in such a way the potential for a sharp production decline, inflation and its impact on the domestic socio-political situation. But, in terms of geographical proximity and transparent boundaries between the republics, the reforms in Uzbekistan could hardly be confined to the national borders. On the contrary, they needed to follow, both in time and strategic tasks, those in other republics. Thus, macroeconomic stabilisation, institutional and production modernisation of the economy, comprehensive development towards a market economy, and the smooth integration into the world economy were common to all of the new independent states.

In line with the determined strategic tasks and real conditions of the early 1990s, the government of Uzbekistan suggested a few key principles on which the economic reforms were due to be fulfilled. They were:

1. de-ideologization of the economy, the latter dominates over the political ambitions
2. state is the main reformer
3. superiority of law, all have to be equal before the law
4. strong social security policy with respect to the most vulnerable strata of the society which made up more than half of the population
5. gradual approach to all the reforms

Uzbekistan was one of the countries which mainly remained reluctant to follow the classical remedies (of international financial institutions) to reach economic stabilisation via decisive and tough measures.⁵¹ The official policy discourse repeatedly underlined that each of the aforementioned principles which are closely intertwined had to take into account local conditions. For instance, the bone of the Uzbek strategy – gradualism is widely explained as having a less painful effect on the population during the economic reforms. On the other hand, in the short run it is simply impossible to change the way of thinking among people with respect to the social and production processes. It will take a long time to fully overcome old ideas in the contemporary production process.

the initial stage of its development. Nevertheless, soon the national discourses ultimately emphasized that the country's specific domestic conditions would necessitate the development of its own model of reforms.

⁵¹ The Washington Consensus proposed by the IMF in Latin America in the 1980s was also urged as to transition economies through a number of parallel sweep measures on macroeconomic stabilisation and trade liberalisation. See: Smith A. Eastern European Economies, in Eastern Europe and the CIS, Paris, OECD, 1999. p.62-73.

In this regard, the peculiarity of the gradualism in Uzbekistan is in that no time limit is established for any stage of reforms. This approach proposes to use a qualitative rather than quantitative evaluation of reforms which implies that the next step will be made only if the previous aims have been achieved and necessary pre-conditions are in place to move further. The “gradualism” correlates strongly to social policy objectives. The latter aimed to reach, to a certain degree, social justice and equality in society. The concepts of “justice and equality” in conditions of Uzbekistan’s reforms, comparing to those of socialist society which were utopian, mean to prevent or mitigate as much as possible a wide differentiation in the society between “rich” and “poor” during the transition. Against the background of social problems in the early 1990s in Uzbekistan, there was a high degree of caution not to cause any further destabilization in the country as a result of socially unpopular reforms.

The next important aspect of the development strategy in Uzbekistan lies in the superiority of law. It is strongly required that all economic units and population have to be equal before the law, and have equal initial conditions to participate in economic activities. In this respect, private property among other forms of ownership is a priority and strongly protected by Constitution.⁵²

Finally, the state is an initiator and the main reformer. The official logic believes that in terms of transition it is important not to allow a spontaneous development of events and therefore, tries to keep the leverages of influence in different fields. In the economic sphere, this is seen as a necessary step unless appropriate conditions in the form of true entrepreneurship spirit, strong institutions encouraging market relations, as well as the credibility of market relations among population, are developed. Thus, the state needs to coordinate the whole transition process. Later on, the role of state has to be decreased gradually. As a result of the decentralisation process, its main functions may be transferred to the local authorities, while the economic processes will start to be regulated by the market itself.

2.2.2. The Key Spheres of Reforms during the First Phase (1991-1996)

Determination of Priorities

*“To eliminate the one-sided commodity-based orientation of the Uzbekistan’s economy is the most important strategy of domestic policy of the republic. The countries which produce and trade in commodities only are doomed to a chronic backwardness”.*⁵³

⁵² A special article on the protection of private property was introduced in the Constitution.

⁵³ Translated by the author from Karimov I. (1992) O’zbekiston – o’z istiqlol va taraqqiyot yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.53.

Taking into account the way and content of market transformation in Uzbekistan, the reforms could be divided into a few important stages. The stage in the given context may imply a set of goals and tasks of a high priority to be solved before pushing through with further reforms.

The first phase of market transformation implied macroeconomic stabilisation and institutional changes as well as the creation of the necessary pre-requisites for the next step. The main directions at that time were to create the foundation of legal regulation of the economy; to pursue anti-crisis policy with the focus on the support of basic industrial (primarily mining and manufacturing) industries; to meet the requirements of domestic demand for foodstuff; to reform the system of the government regulation over the economy; to set up necessary conditions for market relations as well as the development of private entrepreneurship.

To achieve macroeconomic stabilization was a lynchpin of those changes. Although some authors point at low degree of integration of domestic economy into the Soviet system as a reason of more or less stable situation in the economy⁵⁴, the low level of production efficiency in agriculture and huge transfers from Union budget made the economic terms sharply fragile with respect to external factors. Moreover, though agriculture was producing about 1/3 of total GDP, it could not meet fully the domestic demand for foodstuff. As a result, the republic was forced to import many consumer products such as grain, milk and meat products, potatoes, sugar. Therefore, the government was set to undertake to deal with these problems as fast as possible choosing between socio-political issues and economic deterioration..

In the first years of independence (1991-1993) the government sought to control everything, so that to make the process to develop in due course. Within the given period the relations between Moscow and the former Soviet republics continued to deteriorate. Russia still went on playing the role of the Center for some time as a successor to the USSR. For example, in the monetary sphere, the banknotes of Russian Central Bank were in the circulation in all the republics. Political processes dominated over the economic development. Under the motions of long-awaited independence and democracy all economic processes for some period became of secondary importance. The mythical attempt of the Russian government led by Yegor Gaydar (Prime-Minister of Russia at that time) to build up a market economy for “500 days”⁵⁵ not only brought the Russian Federation into the sharp and long-lasting crisis, but also

⁵⁴ Primarily the question concerns the lower degree of industrial contribution in the whole Union economy, only 14% of GDP in comparison with 36% for agriculture and services each. See Zettelmeyer J. (1999) “The Uzbek Growth Puzzle”. IMF Working Staff paper. Vol.46. No.3

⁵⁵ That was the name of socio-economic program suggested by the Russian government on fast and comprehensive transformation of the socialist system to a market economy for 500 working days.

contributed to worsening of the socio-economic situation in other republics in view of the fact that the latter were still strongly related to Moscow. Such situation resulted in deteriorating economic ties between all the republics. The economic exchange of commodities (barter) replaced civilian payments with money. The worsening life standards which was reinforced by the deterioration of domestic macroeconomic conditions in all the republics, was prompting prudent macroeconomic stabilisation programs (See Annex 2.3, Table (a)).

Under such circumstances, the government of Uzbekistan chose industrial branches as the main target of its support seeing them as a potential drive for development in the post-stabilisation era. Moreover, by doing so, the government sought not only to offset the overall production decline in the economy, but to create independent local industries as well which would explore national mineral base. The latter was also critical for the state in terms of stable revenues for the republican budget to compensate, to a certain degree, the abolished budgetary transfers from Moscow after the collapse of the Soviet Union.

As was mentioned, the former system left Uzbekistan the industries which were producing low value-added. The majority of such industries were located in big cities. At the meantime they were closely connected to other similar plants and factories in other Soviet republics making up so called the Soviet type of regional specialization in production. Exporting primary commodities, Uzbek enterprises in turn were provided with raw materials too, such as oil and gas, metal, timber. After the break-up of traditional economic relations with suppliers from Russia, Ukraine, Kazakhstan and others, caused by the deterioration of economic and political processes in the Soviet republics, it was the government which had committed to keep up domestic investment and production activities of local producers. It started an import-substitution policy within a few key industries, especially in the energy and oil sphere by investing into the exploration and development of the new mining areas. This policy aimed at providing a continuous production process of domestic industries. The government was reluctant to give a wide access for foreign investors to explore the main components of its mineral base. The government succeeded in obtaining needed resources through intensive export of raw cotton and precious metals such as gold, copper, zinc, to the world markets, so that to carry out such wide-range state-financed investment programs and projects. And what is more, in view of increasing poor solvency of the traditional partners among the former Soviet republics, Uzbekistan began seeking new consumers for its products, primarily aiming at entering new western markets where the commodities might be sold at much higher prices than in the traditional markets. On the other hand, the government stuck to former methods of control and regulation over the economy at the expense of explicit support of state

enterprises through the centralized credits, redistribution of income and funds provided by the Ministry of Finance and Central Bank. In such a way, the government sought to relieve business atmosphere in real sector by resisting widespread external shocks of that period.

*“In order to carry out structural changes and to solve urgent social issues, and whereas the needs of the republic for foreign exchange resources, it is cotton, fibre, lint, cocoons, non-ferrous metals, kaprolaktam, carbamid and other products that will remain as the main exports”.*⁵⁶

Such an approach resulted in the following policy measures. Taking into consideration the great dependency of the republic on the imported foodstuffs, the government eliminated all import customs for any products until July 1, 1995. The goal was to address the problem of imbalances in the domestic consumer market. Stagnation of the agrarian sector began in the Soviet time and required decisive structural reforms. For this reason it was simply unable to produce the amount of products which was claimed by domestic demand. For example, in 1994, the republic proceeded import a large portion of wheat (66%), meat (30%), milk (25%), potatoes (50%).⁵⁷

The government also approached gradually to the issues of price liberalisation. Starting with January 10, 1992, the prices and tariffs on a wide range of production goods, on some categories of consumer goods and services were basically liberalised. However, some consumer items such as food, utilities, housing, transport, and energy were heavily subsidized until the mid of 1994. The World Bank estimated that consumer subsidies and enterprise credits amounted to at least 21% of GDP in 1999.⁵⁸ At that period the goods of social significance (medicine, bread, soap, oil and oth.) remained under the control of the government. The distribution of such goods through coupon system was introduced.

The year 1994 marked a significant stage in the process of price liberalisation. That year the prices on main consumer products (including bread and flour) as well as tariffs on transport and housing services were largely liberalized. And starting with 1995, prices on almost all consumer goods were freed, though those on oil and oil products were still lower the world level.

⁵⁶ Translated by the author from Karimov I. (1992) O'zbekiston – o'z istiqloq va taraqqiyot yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.33.

⁵⁷ Investment Guide for Uzbekistan (1996). Center for Cooperation with the Economies in Transition. Paris. p.29

⁵⁸ The same. p.32

Fiscal and Monetary Policies

The stage-by-stage liberalisation of prices was expected to limit price increases on the consumer goods and on production inputs decreasing their negative social impact. However, as a rule, such policy is usually related to additional costs for the state budget. In terms of Uzbekistan this problem proved even more complex. On the one hand, after the removal of budget transfers from Moscow, the republic needed to stabilize a huge domestic fiscal imbalance which sometimes reached double digits during the first years of independence. On the other hand, the state embarked on the way of active government assistance to support real sector and social security policy. To some degree, the two purposes were rather controversial and, therefore, hardly attainable. Macroeconomic stabilisation (i.e. lower inflation and budget deficit) could be achieved usually through restrictive budget and monetary policies as well as via a strict financial discipline in the economy. It was reasonable to expect that the consumer and producer subsidies could only encourage financial instability in the economy. As a result, Uzbekistan had a fiscal deficit of 11 % of GDP in 1992, 9% in 1993, about 6-7% in 1994 and about 4% in 1995.⁵⁹ However, they do not include off-budget expenditures such as credits to enterprises extended by the Ministry of Finance. If they were included, the World Bank would estimate much higher figures (for example, 16% in 1993). It is obvious that at that period the government financed its budget deficit mainly through gold and cotton sales, and via introduction of some new taxes (for instance, value-added tax (VAT)).

Simultaneously, some reforms in the monetary area related to the creation of a two-tier banking system and the introduction of new national currency could be also considered among the main targets of the given period. Before autumn, 1993, it was hardly to speak about monetary policy of independent Uzbekistan, because at that time all the former Soviet republics were still within the common national currency area used Russian rouble. The consequences could be two-pronged. On the one hand, such a situation allowed for the states to settle accounts in common currency, that undoubtedly eased up and encouraged the development of trade and economic relations between the republics. On the other hand, all the republics were not independent in pursuing their monetary policy, because it was the Bank of Russia that had an exclusive right for any cash emission.⁶⁰ The republics had just to accept for the granted the monetary parameters and indicators set by the Bank of Russia. In terms of the

⁵⁹ Investment Guide for Uzbekistan (1996). Center for Cooperation with the Economies in Transition. Paris p.31

⁶⁰ Equally, however, in terms of cash shortages, the republics could also expand money supply by conducting non-cash payments, both in domestic and inter-republican transactions, fuelling hyperinflationary trends across the whole common currency space. It soon became one of the main issues in debates in the monetary sector between Russia and other republics which used Russian roubles.

critical situation in the economy, the latter sought, but was barely able to maintain the efficient (i.e. restrictive) control over the bank emission that very often gave a push for hyperinflation both in Russia and other Soviet republics which used the Russian currency.⁶¹ Moreover, inflation was fuelled, in a number of ways, by domestic policy such as lifting subsidies, increases in administered prices and easy credit to enterprises. As long as Uzbekistan remained in the rouble zone, the options for controlling inflation, like in other republics, were limited since it had no control over the emission of the Central Bank of Russia. Moreover, soon Kyrgyzstan had been first among the Central Asian states to introduce its own national currency in May, 1993. According to some estimates, Kyrgyzstan had about 55 bln.roubles in circulation, of which only 6 bln. were exchanged for a new national currency.⁶² Taking into consideration the fact that Kyrgyzstan introduced its currency without any notice of its neighbors, the unchanged amount of money (or 49 bln.roubles) posed a real threat to the entire region in the form of huge cash overhang and heavy inflationary pressure.

In such conditions Uzbekistan left the rouble zone in November, 1993. The state issued an interim currency, the sum-coupon. Lack of familiarity with a new means of exchange and general uncertainty resulted in a round of price increases. Hyperinflation continued for the first six months of 1994.

But, the second phase of the transition to the national currency went smoothly. In July, 1994 the sum-coupons were withdrawn, and new currency, sum, took its place. By introducing a new currency unit in proportion of 1 new sum for 1000 old som-coupons, the government succeeded in reducing extra money supply. The rest of som-coupons in circulation were put into deposits, which were frozen for 1 month. Restrictions on the emission of the new currency in form of cash resulted in a temporary cash shortage, and some enterprises even were unable to pay wages. It is estimated that the value of hard cash in circulation in July and August, 1994, was only 30% of those in June. Abolition of consumer subsidies also depressed income and consumer demand. In August the economy even faced deflation. But in October and November it run again to 20% (after all wages were made for the first time in many months).

Nevertheless, the reform in banking was fulfilled simultaneously. The Soviet system was replaced by a two-tier banking system with the Central Bank (CBU) at the head and about 30 commercial banks. But the functions of monetary authorities were performed by several

⁶¹ For instance, in Uzbekistan inflation of wholesale prices was at 2700% in 1992 , 1100% in 1993, 1248% in 1994. EBRD. Uzbekistan – Macroeconomic Indicators. 2001

⁶² Mandelbaum M. (ed.) (1994) Central Asia and the World: Kazakhstan, Uzbekistan, Tadjikistan, Kyrgyzstan, Turkmenistan. Council on Foreign Relations Press. New York. p.40

institutions. The CBU had an exclusive rights to issue banknotes and coins, and regulate the use of currency within the republic. The CBU provided cash, deposit, and transfer services to the government. It also provided credits to the government at the end of each year to balance its budget deficit. The CBU was supervisor and coordinator of the activities of commercial banks. But the problem was, as mentioned earlier, that credit policy of the CBU within the other priorities of the economic policy, was based on expansionist monetary actions. In addition to this, the CBU provided credit to the Ministry of Finance to meet the working capital of enterprises within the overall support of real sector by the government. And only small amount was available by private sector. Such situation was not only one of the major cause of inflation, but through financing enterprises it inhibited the process restructuring of inefficient economic units.

The activities of commercial banks were strictly limited at that period because of a number of factors. They were: the high level of refinancing rate (250% in 1994); negative interest rates on credits provided by commercial banks; the dependency of the banking sector on the government which implied that banks had to play a role of intermediaries in the allocation of resources from the government to real sector of the economy; high reserve requirements for banks. The creation of a number of specialized banks to support the whole branches of the economy such as Uzagroprombank (agriculture), Uzpromstroybank (industry), a few banks to finance trade and construction brought about a situation where 90% of total credits were provided only by a few banks. In 1993, it provided refinanced credit to agriculture and industry, and via auctions to commercial banks as well. Uzagroprombank (agricultural bank) and Uzpromstroybank (industrial bank) received about 993 mln.roubles in 1993. In contrast only 100 mln.roubles were allocated to commercial banks through auctions. The average interest rate for auctioned credit was 50% which showed that under existing inflationary levels, it faced negative. As a result, most of the loans were converted into grants. The National Bank of Uzbekistan, 100% state commercial bank, was authorized to administer foreign exchange reserves of the government as well as to monopolize foreign exchange market (90% of all forex operations in Uzbekistan at that time).⁶³

On the whole, it might be concluded that the development of the financial sector was put in line with general national macroeconomic strategy. The government considered the banking sector as a key tools of its investment policy to support production process in the real sector. On the other hand, government cautious view was partly explained by avoiding pyramid scams

⁶³ Investment Guide for Uzbekistan (1996). Center for Cooperation with the Economies in Transition. Paris.

and financial abuses such as occurred in Russia and other republics. Thus, the process of liberalisation in the banking sector was postponed.

Another particularity of the Uzbek macroeconomic policy in that period was that the government was strictly restricting any official borrowings from abroad. And taking into account that Uzbekistan did not inherit any of debts of the former Soviet Union, its total external debt remained quite modest. Merchandise exports was about US \$2,940 bln. in 1994, US \$3,475 bln. in 1995, while imports was US \$2,727 bln. and US \$3,238 bln., respectively, that provided trade account surplus. But total current account was in deficit in 1995, due to increase of transport costs of cotton to the world markets as well as to the slump in cotton prices.⁶⁴ At the meantime, gross domestic reserves were estimated US \$1,3 bln. at the end of 1994.⁶⁵

Institutional and Structural Reforms

*“Our goal is that, emanating from all domestic resources, to create such a structure which would allow to secure economic and political independence of Uzbekistan”.*⁶⁶

In line with the tasks of macroeconomic stabilization, the state held active policies on creation of the legal base of the transformation process. In December 1992, the new constitution of sovereign Uzbekistan was adopted to lay a foundation of market reforms in the country. In particular, the constitution secured various types of ownership and overall equality for entrepreneurship activities in new conditions.

On the basis of a new constitution a number of laws and other legislative documents were developed. However, actually it was even earlier when different documents regulating economic activities in Uzbekistan were put into force. Among them, the Law “On property in the Republic of Uzbekistan” dated 31 October, 1990 and amended on 7 May, 1993, which admitted various forms of property in the republic, including private, state, or mixed. Property rights were extended to all tangible and intangible assets, giving any person or an economic unit, to resident or non-resident, the right to own and be the owners of property income. The following remained the property of state:

- land, waters, flora and fauna, other natural resources, cultural and historical cities;

⁶⁴ EBRD. Uzbekistan – Macroeconomic Indicators. 2001

⁶⁵ Investment Guide for Uzbekistan (1996). Center for Cooperation with the Economies in Transition. Paris.

⁶⁶ Translated by the author from Karimov I. (1992) O'zbekiston – o'z istiqloq va taraqqiyot yoli. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.53.

- public places (squares, streets, roads, parks, water reservoirs, beaches and oth.;
- land belonging to natural reserves, botanical gardens;
- land for agricultural cultivation;
- contaminated lands;
- land adjoining the national borders;
- lands allocated for transmission lines, utility routes and communications lines.

The next important Law which is “On Entrepreneurship in the Republic of Uzbekistan” dated 15 February, 1991, guaranteed economic and legal rights, and the responsibilities of entrepreneurs. It mainly declared the freedom of property use, as well as sovereignty to conduct economic activities.

In accordance with the Law “On Exchanges and Exchange activities” dated 2 July, 1992, the legal framework for operation of exchanges with transactions in securities, currency, real estate, intellectual property rights might be undertaken through obtaining special licences of membership and participant of exchanges.

At the same time, the executive bodies, in their turn, were due to work out additional legal acts to put constitutional laws into effect as well as to contribute to the deepening of economic reforms, protection of private property, and the development of entrepreneurship.

These steps were undertaken to induce the process of institutional transformation as well which was implemented in two principal ways. On one hand, most part of government institutions were retained.⁶⁷ The state sought to justify that in new conditions during a period of transition, when true market institutions were absent, even the old plan system could prevent a full collapse of the domestic economy. On the other hand, some institutions were partly or fully reorganised, while a number of absolutely new ones were founded at the same time. In this sense, for example, the external sector faced considerable changes. To replace the existing Republican Committee for Foreign Trade strictly submitted in its actions to the Center in the Soviet time, the Ministry of Foreign Economic Activity was created. The Customs and Tax Committees, the National Bank for Foreign Economic Activity were also founded. The activity of the Ministry of Foreign Affairs (existed in Soviet Uzbekistan) was

⁶⁷ This expression was very popular with the state policies in the first years of reforms (1992-1994), and stood out all institutional changes of that period. The principle was first suggested by the President of Uzbekistan I.Karimov in one of his early books named “Yangi Uyni Qurmay Turib Eskisini Buzmang (Do Not Dismantle Your Old House Until You Build Up a New One)” (1992). Therefore, it reflected one of the main ideas of initial institutional reforms in Uzbekistan.

largely and cordially changed. On the whole, new economic units in face of concerns and associations were created instead of strictly specialized industrial branches.

It is worth underlining that one of the important elements of reforms was structural transformation in the economy. In comparison with the former socialist economy, where state property occupied monopolist positions, a market supposes diversity of property. That's why, privatisation and nationalisation were considered to be integral part of macroeconomic reforms in all transition economies.

In Uzbekistan the situation with a ratio of property in the economy was as follows (Table 2.4). In terms of state monopoly, other forms of ownership were simply suppressed. It is evident that the republic ought to provide equal conditions for the development and competition among all - private, state, or mixed forms of properties.

Table 2.4 Fixed Capital Data by Forms of Ownership in Uzbekistan and the whole USSR, in bln. Soviet roubles

	<i>USSR</i>			<i>Uzbekistan</i>		
	1980	1985	1990	1980	1985	1990
Total Fixed Capital, including	1742	2333	2958	56,1	77,8	100,9
State Property	1514	2049	2624	48,5	68,2	87,3
Cooperative Property	27	37	56	1,1	1,8	2,9
Collective Farms	128	173	192	3,7	4,7	5,2
Private Property	73	74	86	2,8	3,1	5,5

Source: Tukhliyev N., Taksanov A. *Natsionalnaya ekonomicheskaya model Uzbekistana*. Tashkent, 2000
 The National Economy of the USSR in 1990. Annual Statistics (in Russian). Moscow, 1991
 The National Economy of Uzbek SSR. 1990. (in Russian). Tashkent, 1991

The non-governmental sector development was given some impetus in the Soviet time in the mid-1980s, beginning from the declaration of perestroyka. At that period the all-Union legislative acts, such as “On cooperatives”, “On individual work activities”, were adopted. They gave a push for the development of those production structures which had been in a shadow sector before. However, even then these newly created forms of property were limited to develop because of both political (restricted by prevailing communist dogmas) and economic factors (with economically non-viable regional and union specialization).

Thus, the process of privatisation was preceded by the adoption of the special Law “On Denationalisation and Privatisation” passed in November 1991 to maintain the transformation

of state enterprises into individually and collectively owned firms, limited liability companies and joint ventures. State enterprises were allowed for the acquisition by the Uzbek citizens, as well as by non-state legal entities created by citizens, foreigners, and foreign legal entities.

To support the privatisation process, a special state body – the Committee for the Management of State Property and Support of Entrepreneurship, was established by Presidential decree in February 1992. It reported directly to the government, and was supposed to formulate the policy and strategy for privatisation; develop the appropriate programs of privatisation; and finally, to coordinate and implement the whole process.

Uzbekistan launched the process of privatisation and denationalization on a step-by-step basis. The experience of other transition economies (Russia, Poland, Hungary, the Czech Republic) was scrutinized too.⁶⁸ Yet the country generally refused the way which had been widely used by the aforementioned countries. The Uzbek President himself tries to give his own explanation of these issues.⁶⁹ He argued that distribution of property on the free of charge basis could lead to undervalue its real price. Secondly, most part of population had no sufficient investment resources to participate in massive privatisation. Therefore, the property could find itself in the hands of only a limited part of people who might be financially more sustainable and, thus, have possibilities to buy up this property. Thirdly, decisive privatisation seems to be a very complicated process which is usually characterised by a sharp decline in production and in the standard of living. In sum, in terms of Uzbekistan everything which could threaten social stability was sorted out and subsequently denied.

In this context, the process of privatisation through the encouragement of the new forms of ownership in agriculture, industry, the trading sector, services, housing, construction and transport, was integral part to reach one of the strategic tasks to create a multistructural economy. Therefore, Uzbekistan preferred to follow some kind of consistency in

⁶⁸ On one hand, Russia and Eastern Europe had much in common in using the way of drastic privatisation which implied that the state property had to be sold or distributed among new owners within relatively short period of time. On the other hand, there were some features for each country. Russia issued a huge number of vouchers (shares) whose total nominal value was supposed to be equal to all state property across the country. Every citizen of Russia had right to own equal number of vouchers which confirmed his individual portion in all state property. These shares were then dispensed in a massive way to all population without any charges. In Poland and Romania, there were also similar shares, but they were distributed not to all people, but only to those over 18 years old.

⁶⁹ President of Uzbekistan I. Karimov personally paid the priority attention to the given issue. He widely gave a critical evaluation of the privatisation process in a “shock” or decisive way which usually accompanied with inefficient distribution of property among new owners as well as with rather negative social consequences at the initial stage as the result of bankruptcies of many enterprises, and increases in number of jobless. By doing this, he justifies individual approach to privatisation in Uzbekistan alluding to the necessity of a gradual attitude which has to be the more reasonable in terms of the republic. See more in Karimov I. (1995) Uzbekistan on the Way of Deepening Economic Reforms. Tashkent

privatisation. The first part of privatisation began with the formation of small and medium-sized enterprises in the different spheres of the economy, and was subsequently called “small privatisation”. As a result of these reforms, approximately 96% of housing became private, or about 1 mln. families got privatised apartments. Most of small enterprises in trading and service sectors were privatised. According to statistics, by 1998 about 91,4 thousand of farming enterprises which owned 413,3 thousand hectares of land, functioned in the economy. More quantities of agricultural products were produced by people themselves. For instance, these numbers were 87,3% for meat, milk – 90,9%, eggs – 69% out of total volume produced in the republic.⁷⁰

The second stage of privatisation covered the years of 1994-1995, and was named “mass privatisation”. It focused on the privatisation of enterprises in light, food, pharmaceuticals industries, procurement network, construction, transport, communication.⁷¹ Enterprises-monopolists were broken up, initially converted in the closed-type joint stock companies and, subsequently into the open-type ones.

In sum, despite uncontested success achieved in some areas of privatisation (the “small-scale” privatisation was remarked as a substantial step towards a market economy), changes in specific areas of the economy were either unfinished or of poor quality in substance. Nevertheless, the process of institutional reforms in the first half of the 1990s looked relatively successful comparing to some other ex-Soviet republics (Annex 2.3, Table (b)).⁷² Against this background, the next steps were expected to continue with the reforms in a much more comprehensive manner, although this still was far from embarking on the way of radical reforms.

2.2.3. Tasks for the Second Phase (1997-2002)

At the given stage of the research, it is necessary to stress that division of the economic reforms in Uzbekistan into a few stages is conditional and based on the principle that shows which factors and to what degree were influencing economic processes, as well as to show how the government policy were responding to such factors. While foreign estimates of the process of economic changes were quite different sometimes, we tried to take into account the

⁷⁰ Tukhliyev N., Taksanov A. *Natsionalnaya ekonomicheskaya model Uzbekistana*. Tashkent. 2000

⁷¹ Tchjen V. (1996) *Osnovy privatizatsii*. Tashkent. p.7

⁷² One needs to emphasize that currently there are a lot of debates on the methodologies of calculation and the subsequent application of aggregate numbers (first column) in different countries which may lead to the inadequate estimation of transformation process. For details see: Pomphret R. *Central Asia since 1991: the Experience of the NIS*. OECD Development Centre Technical Paper 212, Paris, July 2003.

arguments of the both sides to make up a more or less objective picture of the happening in the national economy. From this point of view, we did not proceed from the concrete terms or time limits. Time as to macroeconomic policy within the whole economy and within its sectors and branches may be naturally different by the period during which it was pursued. That is true, for instance, with respect to privatisation and structural transformation issues, foreign exchange and trade regimes. What is important, as we believe, is the necessity to determine the contents and features of transition to market in terms of Uzbekistan.

Deepening Structural Transformation

Due to an emphasis placed on prevention of the slump of production by virtue of intensive investment and trade policies, Uzbekistan managed not only to avoid gloomy predictions in real sector, but was first among all transition economies to see positive economic growth of 1,6% in 1996. Even international financial institutions which had been rather sceptical about the reforms in Uzbekistan, stressed the period 1993-1996 as “the period of reform acceleration”. In particular, it was remarked that “considerable progress was made in almost all reform areas. Prices and trade were liberalized, the rationing system for basic food stuffs was virtually completed... Limited private ownership of land was introduced. The state orders on all agricultural products, except cotton fiber and grain, were eliminated... The system of social protection was significantly reformed and became much simpler and better targeted”.⁷³

Budget deficit was kept at 6,1% in 1994 and 4,1% in 1995. Inflation after surging to 23,2% per month in 1994 in response to price liberalisation and adjustments, fell to an average monthly rate of 6,3% in 1995. The external current account recorded a surplus equivalent to 2,1% of GDP in 1994 and deficit equivalent to 0,2% of GDP in 1995. Official international reserves increased from as \$1,330 mln.USD (5,9 months of imports) in the end of 1994 to \$1,867 mln.USD (6,9 months of imports) in 1995.

In such conditions, the government program of structural reforms received support from the World Bank under the rehabilitation loan which was approved in 1995, and under the Systemic Transformation Program financed by the IMF a little bit earlier.

After some initial achievements, the government of Uzbekistan determined a number of the main priorities of the further transformation process in the economy. Among them were: deepening of the process of privatisation and denationalisation which had been started

⁷³ World Bank (1999) Uzbekistan: Social and Structural Policy Review, Report No 19626.

before⁷⁴; the necessity of economic recovery, creating conditions for long-run economic growth; stable national currency as one of the important indicators of sustainable production process; expansion of national programs of structural changes in the economy to provide needed diversification of the production process⁷⁵; to continue with social security policy in order to avoid sharp social inequality and maintain the general level of income.

The main task which had been put forward by the President of Uzbekistan during the process of privatisation and denationalisation was the development of competitive environment. According to him, this goal could be reached through the formation of a multistructural economic system. *“... It is necessary to eliminate the state monopoly (in the economy), and needs to aspire to create lots of enterprises which are engaged in the activities similar with those of state ones, but only on the basis of various forms of ownership – state, collective, stock, private and other”*.⁷⁶

The second stage of privatisation, which has been considered in the previous chapter, was the period of mass privatisation of small and medium size enterprises in the light and food industries, machine-building, construction and transport, to transform them into open-stock economic units. In September 1996, some special programs were developed in line with recommendations of international financial institutions, on the establishment of Privatisation and Investment Funds (PIF) to accelerate the process of wider participation of population in the processes of privatisation. The PIF were piling up the share packages from different economic units to reinvest them in private sector, both among invited private investors and population.

The program of privatisation of state enterprises did not aim at increasing revenues in the whole national budget. On the contrary, all the funds coming from privatisation were allocated to the post-privatisation support of enterprises and for the development of enterprises through the off-budget funds. And up to 1998, dividends from state investments into the privatised enterprises were directed to further technological modernisation and re-equipment.

⁷⁴ The President of Uzbekistan himself was a strong proponent of this idea and as the Chairman of the Cabinet of Ministers had the legal power to pursue government policy in this area. In the given case, it primarily implied the necessity to find such an owner who would be able to benefit himself, but in course with government and the whole society's strategic goals and interests.

⁷⁵ That meant to develop traditional sectors of the economy like agriculture, light and food industries formerly developed during the Soviet times, and to give a strong push for the development of non-traditional production such as more finished goods with high value added (electronics, machine and equipment).

⁷⁶ Translated by the author from Karimov I. (1998) *Buyuk Kelajak Sari*. Tashkent. p. 339

With the support of the World Bank, in 1998 the government started a program of individual privatisation of the largest and strategically important enterprises in oil and energy, metallurgy, transport, communications, etc. The main meaning of the reforms is to decrease government influence in national economy, especially in the sphere of natural monopolies.⁷⁷ A special focus has been made on foreign investments to encourage their participation in domestic privatisation. According to the decree of the Cabinet of Ministers No 119 dated 2 March, 2001 “On Further Measures on Privatisation and Denationalisation in 2001-2002 with the Attraction of Foreign Investors” about 38 enterprises and banks were expected to be privatized, with 30-75% stock to be sold to foreign investors. Among such enterprises are the Uzbek oil and gas company, the Uzbek Energy Company, enterprises engaged in chemical and cable industries, the Uzbek Telecommunications, a number of cement producing plant. Another 49 enterprises were listed to be sold to investors at full.

Thus, the long list of enterprises to be sold to investors through auctions, concessions and other sale schemes has been endorsed. In 2002, there were about 535 enterprises representing almost all the spheres of the economy, with 50-100% assets for sale.⁷⁸

The Priorities of Investment Policy

In both the agricultural and industrial sectors, the reforms favored import-substitution policy priorities. If on the first-stage reforms focused mainly on the satisfaction of domestic demand for consumer goods, including essential imports, through active public investments into the domestic mining sector to provide continuous industrial production, then during the second stage the state tried to prioritize certain industries to stimulate economic development.

*“During transition, when the government develops and pursues its economic policy, it (government) should keep in mind that one must seek to encourage the prospective industries, those of most priority, i.e. it is important to determine key bars (like oil and oil independence, energy and energy independence, grain and grain independence and so on) which might promote structural reconstruction of the entire economy... Without singling out such leading branches clearly, without rendering necessary assistance to them, one may then lose the economic strategy as a whole...”*⁷⁹

⁷⁷ In the energy field, special foreign investment bank was invited to take part in the evaluation of the property, make up restructuring plan and promote financial sustainability strategy for the sector. See the next chapter for details.

⁷⁸ Magazine *Ekonomicheskoye obozreniye*. Tashkent. 2001. No 8-9. p.10

⁷⁹ Translated by the author from Karimov I. (1998) *Buyuk Kelajak Sari*. Tashkent. p. 355

Being strongly dependent on imported grain, the state kept up intentions to develop domestic production of grain via shrinking in cultivated areas for cotton (from 1,7 in 1993 to 1,5 mln.hectares in further years). Respectively, the areas for grain production were increased from 1,3 mln. hectares in 1993 to 1,7 mln. hectares in further years, including the lands for production of wheat – from 0,7 mln. hectares in 1993, up to 1,4 mln. hectares in 1998. All this resulted in substantial increase in domestic production of grain from 0,9 mln. tons in 1993 up to 3,6 mln. tons in 1998 and 4,1 mln. tons later on.⁸⁰

At the same time the achievement of macroeconomic stability and economic growth in 1996 made the government to espouse greater ambitions in pursuing investment and industrial policies, as well as further structural changes. The government started developing more capital-intensive investment programs, particularly trying to make them more attractive for foreign capital. The government relied on foreign investors efforts to carry out technological modernisation of a number of existing production as well as creation of absolutely new ones. One of the ever largest joint industrial projects with foreign capital was the construction of auto plant “UZDAEWOO” in Asaka (the Andijan region in the Ferghana Valley) with general capacities to produce up to 200 thousand middle class cars per year.

In line with the priorities to meet domestic needs in energy products through the development and exploration of the domestic energy base, huge investments were attracted, mainly foreign borrowings, to create and upgrade production and infrastructure facilities in the energy sector. During 1996-1997 a new Bukhara Oil Refinery Plant and the reconstructed Ferghana Oil Refinery Plants were put into operation. As a result, in 1997-1998 it provided the increase in domestic oil production and refinery by 3,3 times comparing to 1990 which gave the opportunity not only to satisfy domestic demand, but to become net regional exporter of energy products.⁸¹

Usually by the determination of the key priorities for each year, the government tried to be more consequent. In this respect, since 1995 and up to 1998 the government enhanced the activities to operate not only in the domestic market, but to seek the opportunities for export. The state tried to attract investors both in specific sectors of the economy and the development of certain territories and regions of the republic by granting various fiscal and legal privileges. For instance, by developing these traditional sectors of the economy like light and food industry (tomato pasta and sauce, cotton oil refinery, wines, fruits and vegetables)

⁸⁰ IMF (2000) Republic of Uzbekistan: Recent Economic Developments. IMF Staff Country Report. No 00/36. p.42

⁸¹ These issues are analysed in detail in the following chapter.

the government strongly counted on solving its strategical tasks: to diversify exports through development of finished products with high value-added. And foreign investors included in the government investment program of a high priority gained a number of substantial privileges, primarily through an exemption from paying different taxes on profits, income, on assets and so on, up to 5 years.

The sector distribution of investments confirms the emphasis placed on the technological modernization and development of industrial output, while priorities in agriculture are confined to structural reforms and the changes in forms of ownership. For instance, while investments in the agricultural sector were kept up at 6-7% during the period 1995-1998, the size of investments in industry formed 29% in 1998, even though this indicator was by 20 percentage points lower comparing to 1995.⁸²

Overview of Changes in the External Sector

In terms of international economics, Uzbekistan might be characterized as a small, open economy. As a rule, such economy takes active part in international economic relations and thus, is strongly dependent on global economic processes. The share of the external sector in total GDP is rather high that could be one of the key factors to influence domestic economic policy. Therefore, this specific interrelationship is important to analyse economic strategy as a whole.

It has been stressed before that during the period 1991-1994, the government encouraged imports of consumer and a number of industrial products through elimination of all import tariffs. The government monopoly in foreign trade was ceased, and legal and institutional changes were made to stimulate enterprises' export activities.

On the next stage (1995-1998) the focus of state policy was placed on the development of industries using local raw materials (not imported) and seeking for export opportunities. The state decreased number of goods which were subject to quota and licensing process from 71 to only 4 articles (cotton, grain, energy products, precious metals). Maximum export custom rate was established at as much as 40%, while one third of total export was eliminated at all. Export-oriented industries gained substantial privileges in forms of sliding tax rates and an access to financial resources.

The share of export and import in GDP in 1996 amounted to 34,2% and 34,5%, respectively. Economic growth at 1,6% in 1996 was to some extent achieved by virtue of the highest levels

⁸² IMF (2000) Republic of Uzbekistan: Recent Economic Developments. IMF Staff Country Report. No 00/36.

of foreign trade turnover (\$9 bln.USD) for all years of independence⁸³, or by 18% increase relatively to 1995.⁸⁴

Mainly this situation could be explained by favorable conditions in the world markets for basic export commodities of Uzbekistan (cotton and gold). Cotton export was equal to 40,7, 51,3, 45,6 and 43,5% of total export in 1993-1996, respectively. Cotton and gold together provided about 70% of total export revenues. Undoubtedly, these sources of export revenues helped maintain domestic production levels and budget revenues on more or less stable levels in comparison with other transition economies. However, such exports could be hardly regarded as stable in the middle- or long-run perspective due to high dependency on the volatility of world commodity prices.⁸⁵

In this regard, the changes in terms of trade against Uzbekistan probably were among the most important factors which had influenced on further domestic economic processes. In 1996-1999 time period Uzbekistan faced a number of economic shocks which could be divided into internal and external. As an internal shock it was a supply shock because of the poorer than expected cotton and grain harvests. Agricultural production suffered a severe contraction by about 7%, which was mainly affected by bad weather conditions, as well as by poor irrigation systems and shortages of fuel, spare parts, and pesticides. Because of the contraction in the sector, the share of agriculture in GDP declined up to 23% in 1996. Production of cotton, the country's principal agricultural crop and export commodity, fell by about 15% from an average of 4 mln. tonnes during 1993-1995 to 3,4 mln. tonnes in 1996. Horticulture was also affected by poor weather conditions in 1996 as production of fruits and vegetables fell by 9% and 3%, respectively. In contrast, the grain production grew from 3,2 mln. tonnes in 1995 to 3,5 mln. tonnes in 1996 largely because of an increase in the total area under grain from 1,6 mln. tonnes hectares in 1995 to 1,9 mln. hectares in 1996. However, the total grain production was still below the government's target of 4,5 mln. tonnes. At the same time, grain production became inefficient as the average grain yield fell from 2,1 tonnes per hectare in 1995 to 1,9 tonnes per hectare in 1996.⁸⁶

Similarly, the republic recorded external shock in 1997 which was mainly characterized by a sharp slump in world prices on cotton and precious metals. Thus, average world prices on

⁸³ UNDP (1999). Uzbekistan. Human Development Report

⁸⁴ IMF (2000) Republic of Uzbekistan: Recent Economic Developments. IMF Staff Country Report. No 00/36.

⁸⁵ The same.

⁸⁶ IMF (1999) Republic of Uzbekistan: Recent Economic Developments in 1998-1999. IMF Staff Country Report.

cotton decreased by 16% in 1996, by more than 14% in 1997, even more by 8,5% in 1998. Gold devalued by 40% for the years 1997-1998.⁸⁷

As a result, the balance of payments position worsened significantly. Total export earnings in 1998 were 22% lower than in 1997. The value of cotton exports from the 1998 harvest was about 44,5% lower than from the 1997 harvest. Because of price decline, the value of gold exports was 11% lower in 1998 than in 1997.⁸⁸ Accordingly, under some estimates, only in 1998, because of the decline in world prices on oil, cotton and copper, the republic lost about \$ 170-180 mln. USD.

At that period, earnings from the export of manufactured goods also declined because of reduced demand from CIS (Commonwealth of Independence States) countries and the erosion of price competitiveness. The official real effective exchange rate, one of the main indicators of competitiveness of the country's exports, vis-a-vis CIS countries appreciated by 42% from June 1998 to September 1999. Consequently, the competitiveness of manufacturing exports such as automobiles produced by domestic "UZDAEWOO" plant and sold basically in Russia, was seriously eroded, because of Russian financial crisis in August, 1999. At that time Russia engaged in more than a half of foreign trade of Uzbekistan with CIS countries and remained important partner for the republic. In general, total exports to CIS countries declined by about 50% in 1998 and further decline had been recorded in 1999.

Responding to the aforementioned shocks, the government imposed restrictions on foreign trade and exchange operations to protect international reserves. Import tariffs were raised, pre-import registration of contracts, and excise taxes on imports were introduced, and the coverage of centralised exports⁸⁹ increased. Foreign exchange surrender for exports⁹⁰ at the level 30% of exports earnings was also introduced. The official foreign exchange market was split into two parts: the currency exchange and the commercial market.⁹¹ As a result of such a policy, multiple exchange rates emerged while foreign exchange restrictions led to the development of curb market.

⁸⁷ Magazine *Ekonomicheskoye obozreniye*. Tashkent. 2001. No 8-9. p.18

⁸⁸ IMF (2000) Republic of Uzbekistan: Recent Economic Developments. IMF Staff Country Report. No 00/36.

⁸⁹ By the centralized export in Uzbekistan export of strategic commodities, primarily cotton and gold was considered

⁹⁰ In terms of foreign economic restrictions the government, trying to keep up its own foreign exchange revenues, obliges economic units to sell part of export earnings to the Central Bank at more appreciated official exchange rate.

⁹¹ Currency was sold to those economic units (mostly importers of industrial products and consumer goods) who had preliminarily gained an appropriate permission from the authorities. Commercial market was organised by commercial banks for forex operations between themselves and to service population. The foreign exchange market structure is more completely covered further.

At the macro-level, both fiscal and monetary policies, were significantly relaxed, especially in 1996, due to the large budgetary lending to the agricultural sector (to some extent, to offset harvest decline) and the pension system. Consolidated budget deficit reached to 15% of GDP in the end of 1996 and 7,3% for the whole year. And about 6,9% of this deficit was financed by banking system. Reserve money grew by 84% over the last three months of 1996 that caused a 57% increase in broad money.

These actions, however, also brought about a breach of the program targets under the Stand-by Arrangement (SBA) provided by IMF in December, 1995. The IMF suspended disbursements under the SBA in December, 1996. But, starting with 1997, due to the government's tightening financial policies so that to increase budget revenues and curtail on-lending activities, one was managed to reduce budget deficit up to 2,3% of GDP. Central Bank managed to contain the annual growth rate of reserve money to 18% and broad money to 36%. As a result, monthly inflation fell to 2,1 % (in comparison with 10,5% in 1996).

In terms of contemporary international economics it is foreign exchange regime which could be used as an efficient instrument of macroeconomic policy to determine the redistribution of resources among various economic sectors through prolific manipulation of exchange rates. The economic reforms in Uzbekistan during 1996-2000 allow to demonstrate how a comprehensive effect such policies may have on domestic trends.

Uzbekistan is one of the transition economies which have operated segmented forex market and multiple exchange rate a component of the whole macroeconomic strategy. This system was first created as an emergency response to growing balance of payments pressures following an expected deterioration of country's terms-of-trade position. The government justified the use of current account restrictions with a need to direct resources from traditional exports (cotton, gold, minerals) to the development of capital-intensive, import-substitution industrial base (automobile, energy, chemical industries) as well to subsidize socially important consumer goods imports. Therefore, some international experts come to conclusion that "foreign exchange regime has thus become the cornerstone of "Uzbek economic model of development".⁹²

Since 1997, the foreign exchange regime consisted of a few segments: two official and one unofficial. The first official segment was the Uzbek Republican Currency Exchange where access was restricted by the government, and supply of currency was enforced, because

⁹² Rosenberg Ch., De Zeew M. (2001) Welfare Effects of Uzbekistan's Exchange Regime. IMF Staff Papers. Vol.48. No 1.

demand always exceeded supply of foreign exchange. A special Republican Monetary commission decided who could buy forex and how much. Access to the auction market was granted to certain importers of capital goods, raw materials, grain, and some priority consumer goods as well as to enterprises servicing foreign loans guaranteed by the government. The latter also could buy forex to service its own external debt.

The second official segment of Uzbekistan foreign exchange market was a commercial bank market, where commercial banks and exchange offices trade foreign currency with other banks, enterprises and individuals. The government also regulated this segment by controlling demand and supply. The primary uses of forex sold in this segment were approved imports of capital and intermediary goods as well as imports of consumer goods by owners of the Central Bank's license within the Central Bank determined quotas. The main sources of foreign exchange supply in this segment were surrender requirement for decentralised exports (all, except cotton, gold, energy), which was first 30%, then 50% from January 1, 1999.

As far as there was strongly unsatisfied domestic demand for foreign exchange, unofficial curb foreign exchange market started developing on which national currency was traded at lower exchange rates than in official segments.⁹³ Such foreign exchange regime was preserved until 2000 with a little change. The consequences of the regime manifested in some inter-sector distortions which we will consider in the next chapters.

New Opportunities for Small and Medium-sized Enterprises

The period from 1999 may represent a new phase of economic reforms in Uzbekistan. The following issues are quite the relevance to illuminate the most important priorities for the given period: the development of small- and medium-sized business, the encouragement of export-oriented industries, and overall liberalisation of the economy.

Taking into consideration the necessity to give a more strong impetus for the development of export-oriented industries, the government worked out a Program on the Development of Export Potential which aimed at creating favorable conditions for exports increase and its structural improvements. This program served as a basis to the elaboration of a number of small-scale and detailed regional programs dealing with concrete branches and sectors of the economy in more practical way. This program resulted in creating joint ventures with foreign capital, especially in the textile and food industries allowing to increase the number of diversified finished goods for export produced from cotton fibre and agricultural products.

⁹³ The difference was equal about 100% in the mid of 1998 and even increased up to 400% in 1999. For more details see: Rosenberg Ch., De Zeew M. (2001) Welfare Effects of Uzbekistan's Exchange Regime. IMF Staff Papers. Vol.48. No 1.

Uzbekistan also started exports of automobiles, buses and agricultural combines, as well as a number of home appliances and electrical equipment, benzine, diesel, wire and others. In addition, a number of services (tourist, transport) are provided recording wider export potential of the domestic economy.

At the meantime, one of the key priorities of the state policy during the recent years was comprehensive development of small- and medium-sized business (SMB). Delivering a speech at one of the government meetings, President I.Karimov noticed that *“small- and medium-sized business is a key element of any developed economy which influence successfully not only on large-scale industries, but on the economy as a whole, providing a huge number of consumer products and services to a domestic market, developing export potential of the economy, addressing problems of unemployment and raising the standards of living of population”*.⁹⁴

For Uzbekistan that was particularly important for a number of reasons. Firstly, relatively fast growth of population and labor, especially in rural areas required to create adequate number of jobs. Small business was invited to ease up this problem. Secondly, in terms of transition, SMB is considered to be more flexible, quickly adapting to any changes in the economy. This meant that small enterprises could survive in a more efficient way during transition comparing to large ones which suffered from structural adjustment costs.

Therefore, the government started with a campaign on the comprehensive support to SMB. It created new institutional structures such as the Fund on support and development of private entrepreneurship (Business Fund), the fund of assistance to the development of small and medium entrepreneurship, Tadbirkorbank, the Consulting Agency (Konsauditinform), the Chamber of Commerce, Producers and Entrepreneurs. All of them were non-governmental institutions which were responsible for providing financial and consulting support directly to entrepreneurs. Besides, the state provided a number of tax privileges, simplified taxation⁹⁵ and registration of entrepreneurs in government bodies.

On the other hand, this policy was supported by international financial and non-governmental organizations. Among them were the European Bank on Reconstruction and Development, Asian Development Bank, OECF (Japan), International Financial Corporation, Credit Development Agency of Germany, the Central American Fund on Entrepreneurship

⁹⁴ The speech was made by the President I.Karimov at the meeting dedicated to the evaluation and discussions on the process and results of domestic economic reforms for the first half of 2001.

⁹⁵ One of the great achievements was that SMB might pay only one common tax instead of a number of taxes on profits, assets, land, VAT and others which were paid before. And what is more, new tax was much lower than all previous taxes which were paid by enterprises in a separate way.

Development. They expressed their readiness to provide financial assistance to private sector. According to official statistics, in 2000, the volume of credits to SMB exceeded 92 bln. sums which was 2,5 times higher than in 1999. Off-budget funds financed some projects with total value of 4,4 bln. sums (1,7 times higher than in 1999).⁹⁶

As a result of government policy, the number of small and medium enterprises fast reached the number 186 thousand as of 1 April, 2001 (in comparison 9343 in 1991). The share of SMB in total GDP was equal to 21,6%, including in total industrial output - 11,3%, in agricultural output – 72,4%, 37% - in construction industry, 45,9% - retail trade.⁹⁷ The government repeatedly pledged itself on firm commitments to provide further comprehensive support to small and medium enterprises both in middle- and long-run prospective.

With strong commitments to liberalisation and further market-oriented reforms declared by the government in 1999, liberalisation of foreign exchange regime and the elimination of multiple exchange rate system were of significant attention. Since 1998 Uzbekistan has been gradually moving to the unification of multiple exchange rates. During the year 2000 the Central Bank devalued official exchange rate by 57%. In the mid of 2000, it was introduced commercial exchange rate two times higher than official exchange rate. Starting with July, 2001, one was introduced so called “over-the-counter”⁹⁸ rate which ought to reflect real demand and supply within the forex market in the republic.

In sum, the process of transition turned out to be equally controversial in all former Soviet republics which had to face a large number of similar problems. However, the peculiarities of economic strategy in each single country resulted in a various extent of economic progress.⁹⁹ As for Uzbekistan, it was also primarily influenced by inherited social and economic problems of the former socialist system. Therefore, the government policy recorded uncontested success on the one hand, while facing huge, more complicated than expected problems, on the other. Consequently, this required more sweeping economic measures from the state to accelerate the period of transition and give a stronger push to sustainable economic boost. Some of these discourses are overviewed in the next chapter.

⁹⁶ Magazine *Ekonomicheskoye obozreniye*. Tashkent. 2001. No 8-9. p.14

⁹⁷ The same.

⁹⁸ For more details see Rosenberg Ch., De Zeew M. (2001) Welfare Effects of Uzbekistan’s Exchange Regime. IMF Staff Papers. Vol.48. No 1. Memorandum of Understanding between the Government of Uzbekistan and the IMF dated January, 2002. (www.imf.org)

⁹⁹ According to some experts (J.Tinbergen), even Eastern Europe, the most advanced in market-oriented reforms among transition economies, will require no less than a few decades on condition of sustainable economic growth at 5-7% to reach the level of national income in the developed market societies. Reference in: Chang Ha-Joon, Nolan P. (ed.) (1995) *The Transformation of the Communist Economies*. London.

2.3. Against the Challenges of Transition

2.3.1. Discourses on the Overall Strategy of Reforms

The process of transition from a socialist to market economy in Uzbekistan seems to be a complex task from the very outset. The range of factors to influence domestic processes has been quite different. The socio-economic development has to be seen in the context of economic policy in form of fast or step-by-step strategy of transformation, the role of state, success in attracting foreign investments, etc, and political processes right after the break-up of the USSR, as well as socio-cultural components of Uzbek market reforms.

Such interrelationship is not new in the world history. It is well-known that after the second World war, the international community saw the establishment of new, post-colonial, sovereign states. The process made the scientific society expand its views relatively political, social and economic processes in different societies. According to some researchers, “*it was obvious that political systems, as well as society and economy in these newly independent countries did not function according to those rules that organised social and economic life in the metropolitan countries of the West, which in their majority were capitalist, liberal democracies*”.¹⁰⁰

Geographical proximity of East Europe to Western countries, that literally speaking, allowed to observe capitalism and democracies development over their national borders, promoted the initial market relations in Yugoslavia, Hungary, as early as in 1960-70s when along with the state enterprises non-state sector development was also encouraged. Thereto, these countries were less influenced by the Communist Party’s interventions in economic life which was a general practice in the Soviet system at that time. Existing domestic pre-requisites combined with the external political, economic and social consolidation with Western Europe urged some Eastern European ruling governments to induce drastic structural measures in the early 1990s and launch the adaptation process to comply with new EU’s standards and rules.¹⁰¹

The former Soviet republics faced not only more acute socio-political processes, which subsequently expressed in ethnic and social conflicts, but also much deeper economic crisis

¹⁰⁰ Wöhrmann F. (2000) Economic Discourse in Uzbekistan. The Perception of Economic Change between Market Principles and Social Traditions. Veilag für Entwicklungspolitik, Saarbrücken. Bochum. p.45.

¹⁰¹ While EU-25 had formally occurred in May 2004, the implications of full “Europeanization” are not monotonic, both for recent members and for second-wave countries. In addition to economic problems, new members and other nominees have also to deal with painstaking and timeconsuming political transformation to integrate their patterns, structures and policies into the EU-urged common regional and subregional hierarchies and institutional arrangements. See more on these issues in Seidelmann R. (ed.) (2002) EU, NATO and the Relationship Between Transformation and External Behavior in Post-Socialist Eastern Europe. The Cases of the Slovak Republic, Bulgaria, Romania and Ukraine, Nomos Verlagsgesellschaft, Baden-Baden.

because of much stronger mutual economic links and specialization. The plan system implied not cooperation, but rather a mutual complementarity of vast economic territories with a various level of socio-political and economic development.

Despite the prevalence of the European culture in the face of Russian-speaking society, and the suppression of national identity and self-determination in the whole Central Asian region, traditional and social relations kept on developing in Uzbekistan. To some degree, this fact was also admitted by the Center. Some authors stressed as to relations in the Asian society that *“in the given society individual interests fully submit to group (family, community, colleagues in workplace) interests. The latter subordinate to the interests of larger groups (strata, classes) which in their turn, do to the state... Such a society is different by its attitude to state property on land which played substantial economic role in the society. State property on land was an alternative to private property”*.¹⁰² The plan system with the monopoly of the state on production means, and the fusion of economic and political power within totalitarian regime might have been relatively easy to introduce in such societies. And in comparison with East European countries, Central Asia stood apart from so called process of “capitalist modernization” which supposed to decrease socio-economic gap between developing and developed societies.

After independence, as was mentioned earlier, Uzbekistan had to choose between a big bang (shock therapy) and gradual strategy. The supporters of the shock therapy suggested a package of decisive measures which are rather comprehensive to reach desired stabilisation, price liberalisation, privatisation of state-owned enterprises, promotion of private sector, and trade liberalisation. The idea of these changes was to mould as closely as possible each aspect of the economy to the free market model. As an essential part of its strategy, the measures proposed to eliminate price controls and trade barriers and by giving a free way to foreign economic units to act on the domestic market. That should encourage domestic competition and stimulate only really profit-making domestic enterprises, while all others have to be decisively closed.

According to other views, *“this approach has been argued that their general suitability to the situation in developing countries has been far from evident and that since stabilisation policies are likely to induce recession, they bear the risk of collapse in the financially and*

¹⁰² Tukhliyev N., Taksanov A. Natsionalnaya ekonomicheskaya model Uzbekistana. Tashkent. 2000. p.27

*structurally fragile economies of transitional or developing countries... The stabilisation could be met at the lower level of economic production”.*¹⁰³

Nevertheless, the World Bank's approach is based on a set of measures to ensure economic stabilization and induce economic growth. First, the trade regime should be liberalized with the transition from non-tariff to tariff methods of regulation; barriers to external capital flows have to be removed and integration of domestic markets with world capital markets; third, deregulation of labor market; fourth, reforms in the tax system; fifth, privatisation and denationalisation. The World Bank strategically adheres to the aims of decreasing the role of a state in the economy, and developing competition environment.

Some authors, alluding to the experience of East Asian countries, believe that the role of state was a key element to the success of industrial policy in providing new export-oriented branches of the economy. For example, South Korea provided substantial state assistance to heavy and chemical industries in the 1970s. In Japan, they were steel, electronics, machinery industries that benefited from state subsidies and protectionism relatively to import.¹⁰⁴

The question in this regard is whether the neo-classical views would have led to the expected changes and economic growth or if their programs have been able to provide the efficient balance in the economy are equally not incontestable.

Nevertheless, Uzbekistan perplexed many international observers by its performance in the mid-1990s. The country which had not follow standard model of market-oriented reforms, faced the least decline in output. 1997 Uzbek output stood at about 85% in 1991, as compared to an average of 60% for the Baltic, Russia and other countries of Eastern Europe and the USSR. Total cumulative loss in output was only 59% of 1991 output by 1995 and 89% by 1997- as opposed to 126 and 207%, respectively, for other transition countries.¹⁰⁵

It is interesting that the IMF model predicted loss of 18,9% in 1994 which did not materialise. Moreover, Uzbekistan got growth of 1,6% in 1996 – the only country in transition. According to the neo-classical point of view, „the mildness of Uzbekistan's transitional recession could be largely explained by a combination of its low degree of initial industrialization, its cotton production (which was re-directed from CIS markets to the world markets), and its near self-sufficiency in energy“.¹⁰⁶ The author of the research questioned an official discourse in

¹⁰³ References to Taylor (1993), Harrigan (1991) are taken from Wöhrmann F. (2000) Economic Discourse in Uzbekistan. The Perception of Economic Change between Market Principles and Social Traditions. Veilag für Entwicklungspolitik, Saarbrücken. Bochum. p.41-42.

¹⁰⁴ Chang Ha-Joon, Nolan P. (ed.) (1995) The Transformation of the Communist Economies. London. p.391

¹⁰⁵ Zettelmeyer J. (1999) “The Uzbek Growth Puzzle”. IMF Working Staff paper. Vol.46. N.3

¹⁰⁶ The same.

Uzbekistan that it was allegedly an appropriate macroeconomic policy of the government with structural and investment changes, which had provided a rather slide decline. At the same time, the author expresses his doubts on that „*the country would have done better by pursuing more vigorous liberalisation and reform policies from the very beginning*“.

Other economists share the official views that relative success of Uzbekistan was based on the following pillars of the economic strategy:

- 1) gradual transition to a socially-oriented market economy with a strong and progress oriented state;
- 2) the development of real sector as a priority;
- 3) intensive industrial policy versus deindustrialization;
- 4) the combination of import substitution and export-orientation policies;
- 5) the gradual opening up and integration with the global economy through step-by-step foreign trade and exchange rate liberalisation.

They conclude that „*the chosen strategy has become one of the main determinants of relatively better output performance in Uzbekistan compared to other CIS countries... which is the key to understand the „Uzbek growth puzzle*“¹⁰⁷.

For our part, the following two aspects might be crucial in explaining the Uzbek gradualism. One of them is that the government asserted its readiness to trade off the lower degree of economic efficiency for the higher degree of social stability with probably hardly optimum, but socially less unpopular, redistribution of national income.

The Uzbek President writes: “*Transition to a market is beyond doubt. It is an order of time, objective reality... In view of the established complicated economic situation, the low level of living standards of many families, transition to a market economy by virtue of big bang measures is unacceptable for the republic... The main task is to make this process as smooth as possible, with safeguarding the least losses for population and avoiding social shakes*”¹⁰⁸

The official policy proceeded from the fact that the low level of local social welfare formed for decades of Soviet ruling in the republic could channel into social explosion and unrest

¹⁰⁷ Islamov B. Once More on „Economic Growth Puzzle“ of Uzbekistan. Magazine *Ekonomicheskoye obozreniye*. No 8-9. p.87.

¹⁰⁸ Translated by the author from Karimov I. (1992) O‘zbekiston – o‘z istiqloq va taraqqiyot yoli. The collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.39.

under the pressure of complex social costs during transition period.¹⁰⁹ It is reasonable to believe that the poor and “hungry” society could hardly be prepared to any appeals and efforts in absorbing and adequately perceiving new democratic and market values. Therefore, according to President Islam Karimov, it would take some time to change the way of thinking in society and bring it closer to the new requirements, to new environment conditions.

The second point is based on the assertion that, when talking about the role of a government in the economy, it sometimes brings little when handling with some common indicators like the share of the state sector in GDP, in aggregate investments, or in aggregate expenditures in the economy, and so on. These figures do not necessarily have to reflect the quality of government influence on the economic processes. On the contrary, the experience of some countries, especially in East Asia, shows, that even if commonly accepted indicators are insignificant in their values, nevertheless, the government has always played a very important role in the domestic progress.

It would thus be more reasonable to look at the tools used to follow general macroeconomic strategy more or less successfully. International financial institutions representing neo-classical and neo-liberal views in modern economic policy, aims at the creation rather stable forex and trade system in country-members and in the world economy on the whole, so that to provide universal and fair terms of trade via the common ways of international financial settlements, free movement of goods, capital and services. On the other hand, a government in the transformation society may have the intentions to find its niche in the world by developing its comparative advantages through nationally prioritised policy instruments which make great concern among the supporters of free international economics. So, in rapidly changing world intentions may not coincide with the reality of modern capitalism. And it is quite more tough task for transition economies which have neither former socialist system of regulation over the economy in their classical type, nor genuine market economy so far, with its more or less independent mechanisms of production process and redistribution of national income.

In this respect, economic reforms seem to be uneasy in several ways. To some extent, the strategy is similar to that of East Asian economies with highly developed industrial branches which have provided overall economic growth and social progress for the last a few decades. However, the pre-requisites, initial conditions and methods of pursuing industrial policy by a state as one of the principal tools of modernisation in the economy could be qualified

¹⁰⁹ These social costs were defined as high inflation, output and real income fell, unemployment, poverty and marginalization of society on “very rich” and “very poor”. See in: Alimov R. and others (eds). *Tsentrlnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost*. Tashkent, 2002. p.42.

differently. Firstly, East Asian countries started with such reforms as early as in 1960-70s (Korea, Hong Kong, Taiwan), Japan – even one decade earlier. At that time the world economy was expanding maintaining stable demand on its part for a number of industrial products produced by East Asian economies (automobiles, ships, home appliances, computers and etc.). These products were in strong need to primarily satisfy quantitative world demand. And only some years later, with markets to be saturated through both a wider assortment of goods and strengthening competition, the quality characteristics were subsequently much more demanded. East Asia with already established flexible production process and a stable network of traditional consumers on the world market, was then able to invest enough to produce products of higher quality. Secondly, in almost all countries of that region the process of industrialisation was carried out with substantial external financial support. At first it was the USA which had supported the Japanese economy after the World War II. Then, Japan itself invested much in the industrial production of other countries of the region (Korea, Taiwan, Singapore, Indonesia) ensuring sustainable success of the “flying geese” model.¹¹⁰

In the given light, Uzbekistan favored import-substitution policy with the subsequent enhancement of export industries too. There are two aspects here which may particularly draw our attention. The first one, as the republic tries to apply two-pronged strategy, the main difficulty with this approach is to provide optimal incentives for all those producers, sectors or branches touched by the policies which vary by substance. In addition, it is also important to see what kind of tools are used by the state to create production incentives in the economy.

Usually, government can collect revenues and redistribute income among sectors and household groups by both explicit taxes and subsidies. The latter could be so called quasi-fiscal operations which can include such mechanisms as multiple currency exchange rates, inflation tax, subsidized and direct lending, non-remunerated reserve requirements and credit ceilings, price and wage controls. All of them were more or less used by Uzbekistan. However, the most significant among them was foreign exchange regime.

The government introduced tough restrictions on forex and trade operations in the last quarter of 1996, trying to offset the pressure on balance of payments, because of a number of shocks (poor cotton harvests, decline in world prices on export commodities – cotton and gold). Moreover, the government declared about the necessity to protect national economy from negative external trends, such as global financial crisis in 1997 and Russian financial crisis of 1998. The government voiced a few reasons to explain these the main of which were:

¹¹⁰ Yi T. FDI Strategy in the Age of Globalization. <http://www.grips.ac.jp/teacher/oono/hp/lecturesF/lec06.htm>

- to contain the deficit of the state budget by reducing the cost of external public debt service and budget-financed imports of capital, intermediaries, and consumer goods;
- to promote the development of import-substituting and export-oriented industries by lowering the costs and increasing the volumes of capital and intermediate goods imports for these industries;
- to support living standards by maintaining relatively low prices for „essential“ consumer goods, such as bread, flour, and vegetable oil;
- to preserve official international reserves.

However, the results of the policies proved to be rather controversial. On one part, it was succeeded in rationalizing the structure of imports in line with the goals of the whole macroeconomic policy (grain and energy independence, technical modernisation of the economy, etc.). In particular, import of oil and oil products was decreased from 25,5% up to 3,8%; foodstuffs – from 36,8% to 12,3%, in 1992 and 2000, respectively. At the same time import of machine and equipment increased from 9,2% to 35,4% during the same period.

On the other part, such a policy resulted in a number of negative consequences the main of which were:

⇒ relaxation of monetary discipline and increase in official real exchange rate of national currency, which obstructed to export and export-oriented branches. 100% foreign exchange surrender for centralised export (cotton, precious metals) and 50% surrender for decentralised export (all other goods) at highly appreciated official exchange rate led, to some extent, to the decrease in foreign trade operations in 1997 and 1998. In particular, in 1997 total foreign trade volume decreased by 4,3% in comparison with 1996, including decrease in export by 4,4% and import by 4,2%. In 1998 foreign trade slowdown was even sharper and equal to 23,5% comparing to 1997, including 19,6% and 27,3% declines in export and import, respectively¹¹¹;

⇒ looming environment and risk, which promoted the decrease in foreign direct investments (FDI) and export-import transactions. For example, according to data provided by EBRD, FDI were equal to \$167 mln. in 1997 and only about \$70 mln. in 2000 recording one of the lowest indicator among transition economies in that year¹¹²;

¹¹¹ UNDP (1999). Uzbekistan. Human Development Report

¹¹² EBRD. Uzbekistan – Macroeconomic Indicators. 2001

- ⇒ distortions in domestic relative prices, which led to inefficient distribution of resources among domestic economic branches and resulted in potential decrease in social welfare¹¹³;
- ⇒ strengthening monopolist enterprises, which hindered the objective development of competition on the part of domestic and foreign economic units. The World Bank pointed out that „this (distorted economy) allows for many enterprises producing negative-value-added at international prices to record profits at distorted domestic prices and to continue operating without restructuring“.¹¹⁴ Moreover, to some extent, it leads to the breach of consumer rights, since state enterprises are unable to operate efficiently in view of new financial environment, at least for some time, and, as a rule, forced to produce goods of lower quality with rather limited assortment and at higher prices;
- ⇒ importers, who have an access to official forex market, have rent profits at the expense of those who do not have such opportunities.¹¹⁵

Of particular attention is the policy in the agricultural sector affected by foreign exchange policy priorities. As far as the sector provided about 50% of foreign exchange and 19% of budget revenues, the state used the resources to finance its industrial projects. Notwithstanding the variety of forms of ownership in agriculture, the influence of state remained substantial. The government withdrew resources from agriculture through the combined mechanism of state procurements of cotton and grain, and multiple forex regime in order to redistribute these resources as investments in other prioritized areas, such the energy complex, for example.¹¹⁶

¹¹³ For instance, according to estimates by the World Bank, as a result of such policy of income redistribution, the public sector's losses amounted to 39,770 mln. sums, or \$398 mln. USD (4,1% GDP with the average rate \$1=100 soums), largely at the expense of losses in mining and energy sectors, Central Bank and National Bank as well (1,7% and 0,7% GDP, respectively). The contribution of these is more strategic rather than a simple indication of the scope of distortion, i.e. they may serve as a pointer to the challenges of suffering industries and the controversy of reforms in some areas. World Bank (1999) Uzbekistan: Social and Structural Policy Review, Report No 19626. p.20.

¹¹⁴ World Bank (1999) Uzbekistan: Social and Structural Policy Review, Report No 19626. p.27.

¹¹⁵ For instance, according to IMF staff calculates, transfers from exporters to importers made up about 16% of GDP. In 1997 import-substituting industries, such as car-manufacturing, electronics and the production of tobacco and soft drinks, which imported capital and intermediate goods worth more than \$800 mln. USD, most of which was obtained through the Republican Exchange. They gained about \$250 mln.USD due to existing difference between official and market-clearing rates. At the same time, export oriented industries faced a loss of more than \$250 mln.USD. Some estimates spoke about welfare losses of 2-8% of GDP on import markets and up to 15% on export markets generated by foreign exchange regime. See World Bank (1999) Uzbekistan: Social and Structural Policy Review, Report No 19626. p.20; Rosenberg Ch., De Zeew M. (2001) Welfare Effects of Uzbekistan's Exchange Regime. IMF Staff Papers. Vol.48. No 1.

¹¹⁶ For instance, up to 2001, the state order system requested farms to sell 30% of the „target“ for cotton production and 25% of the „target“ for wheat production at state determined prices. That implied that agricultural producers forced to sell these products at 51% for cotton and 74% for wheat of the world prices if it is calculated at the official exchange rate. However, actually, these prices were a few times lower compared with world prices if calculated on the basis of underlying market (curb) exchange rate. The wheat included an additional 25% obligatory sale to the state at negotiated prices which were 40% higher than those of state, but still lower than the world ones. The catch thing here is that the farmers sold the volumes calculated not as share of actual harvest, but that of target plans set by the government. If farms failed to meet the plans of the government, they had to sell all the harvest to the state at the official appreciated exchange rate. Since government targets were quite ambitious, they were unattainable for many farmers. Therefore, most part of the harvests were annually sold to the

To somewhat degree mitigate the losses in the agrarian sector, the government maintained the centralised distribution of inputs like fertilisers, seeds, fuel and others, as well as agricultural machinery and equipment. But this system may also be full of drawbacks. Local authorities which supervise such distribution, might influence the commercial decisions of agricultural producers, because this system authorizes local state bodies to choose, who and how much may get from the centrally allocated resources. From the organizational point of view, this system also looks suboptimum, as it creates a fertile ground for the abusements and briberies among local authorities. In terms of limited resources, hypothetically only those who were close to local authorities might be a criterion of such centralized distribution, rather than real economic needs of agricultural producers.

As for other forms of government support, it was VAT exemptions of agricultural producers. According to some data, they amounted to 6,5 bln.soums in 1996, 11 bln.soums in 1997 and 15 bln.soums in 1998. Costs of irrigation which had been fully covered by state budget, were equal approximately 75-85% of all expenses on national economy of Uzbekistan. Producers did not pay for land and water. Many credits to agriculture were usually subsequently converted into credit subsidies and were later on written off. Subsidies for capital investment and for machinery services at more cheap official import also served a kind of government assistance to the sector as a whole.¹¹⁷

Despite some support from the government, the negative influence of state procurements on the largest agricultural products (cotton and grain) at overvalued official exchange rate as well as tough control through licenses over the part which could be sold at free prices, has remained in the limelight of issues in the agricultural sector for the most part of post-independent development.

2.3.2. Unemployment

Uzbekistan is the most populous country in Central Asia comprising over 40% of regional labor force. But the slow down in population growth rates from 2,1% in the first half of 1990s to 1,5% during 2000-2005 has been clearly observed. In 2001, fertility in rural areas remains higher than in urban ones, reflecting the domination of rural population both in total

government at official exchange rates. Some estimates show that these volumes reached 65-75%. See: World Bank (1999) Uzbekistan: Social and Structural Policy Review, Report No 19626. p.13

¹¹⁷ World Bank (1999) Uzbekistan: Social and Structural Policy Review, Report No 19626.

population and its growth rates.¹¹⁸ These figures may serve as a background to unemployment issues.

In the past years the official unemployment rate was very low – less than 1% - barely reflecting undergoing serious structural changes. Yet official statistics covered only those people who voluntarily were coming to authorities to register as unemployed. It gives them the right to have government benefits. However, the unemployed suffer rather low stimulus to register, because of very low size of such benefits. In addition, there is a hidden unemployment. For example, in many economic units, there are certain workers who officially the staff of the company, but actually they do not work being on forced leaves. In this respect, the actual rate of unemployment is expected to exceed official figures. According to some estimates, non-registered unemployment or part-time jobs could fluctuate from 6% to 25% across the country, including differences among the branches of the economy, and regions. For instance, the overview made by the Ministry of Labor in 1997, assessed the hidden unemployment as 5,5%. Losses in labor related to production standing, forced leaves and forced part-time work were evaluated as 1-2% of total labor force.¹¹⁹

The excess of labor force in large state-owned enterprises seems to be an implicit problem. Employers are reluctant to retire huge number of their workers. There are probably two main factors explaining such unwillingness. Firstly, in terms of a shortage of funds for the technical modernisation and re-equipment, the managers prefer to keep up production process via extra number of workers who still are ready to work even for lower wages in order to keep their jobs. Secondly, in most cases, the directors hardly desire to lay off the workers who have recommended themselves as experienced and high skilled staff, and show some kind of “paternalism” by providing them with social benefits and care. Nevertheless on-going structural reforms in agriculture and reorganisation of agrarian enterprises started in 1998, was also promoting the higher number of work force to be sacked.¹²⁰

Besides, unofficial employment is also a case nowadays. In Uzbekistan, primarily in big cities, there is historically developed market of private labor force – “mardikors” where people can be hired for a variety of private works (construction, cultivation of land, different

¹¹⁸ Despite the further decline forecasts, Uzbekistan’s population is expected to double by 2038. In 2001, fertility rate of women between the age 15-49 was 3.74 in rural areas comparing to 2.71 in urban. Thus urban population amounted to about 37%. For more information see: Uzbekistan Population Growth is Decreasing, Interfax News Agency, 19 July 2004, <http://www.uzland.uz/2004/july/21/03.htm>; UNFPA website at www.unfpa.org, country profiles.

¹¹⁹ UNDP (1999). Uzbekistan. Human Development Report. p.46

¹²⁰ In particular, about 280 thousand people had found themselves out of job and as reforms in the sector are under further way, these figures may rise. According to unofficial returns, the excess of labor in agricultural sector may be still equal to 30%. See UNO (2001). Uzbekistan: Obshaya otsenka strany. p.13

home services and etc.). Only in Tashkent, the capital of the republic where usually one can find many opportunities to use such labor, there are about 4-5 private labor markets where daily about 10 thousand of such “mardikors” suggest their services.¹²¹

To resolve the problem of unemployment becomes of crucial importance for Uzbekistan today. Therefore, it remains the top issue in the respective government programs. An official discourse believes that the given issues can be solved through a variety special programs in all sectors of the economy and by developing real sector, in particular in rural areas. In this respect, small and medium-sized business and service infrastructure are among the priorities. According to some data, in 1996-1998 it was about 631 thousand of jobs in the economy which were newly created, and half of them were jobs and private activity in the agrarian sector of the economy.¹²² Notwithstanding the attempts of the government to create jobs through the mixture of direct and market-oriented methods, the issues of employment and creation of new jobs will, most probably, remain pressing problems in the nearest future, especially in terms of the forthcoming liberalisation in the economy.

2.3.3. Income and Poverty

Among the attempts to reach macroeconomic stability through curbing inflationary processes and maintaining reasonable size of budget deficit, the government limited wage increases both in the public sector other spheres of economy.¹²³ As a consequence of such policy, wages faced sharp differences both in regions and in economic branches. The highest wages were remarked in the industrial sector (50% higher that of the republican average), in transport (from 130% to 145% in different years), construction (121,7% in 1992 and 152,4% in 1997), the financial sector (182% in 1992 and up to 216% in 1997). The lowest wages were recorded in public sector (public healthcare, culture and arts, education, sport) with 20-30% lower than the average in the whole economy.¹²⁴ Such differences determined also the regional divergence of income across the republic. Those regions (Tashkent, Andijan, Bukhara, Navoi) with primarily industrial branches of the economy, construction and services outpaced the other territories (the Republic of Karakalpakstan, Djizakh, Syrdarya, Khorezm, Surkhandarya)

¹²¹ Some surveys estimate unofficial unemployment in Uzbekistan at about of 2 mln. people in 1999. See UNDP (1999). Uzbekistan. Human Development Report.

¹²² At the meantime, however, foreign observers are very critical about the way and outcome of this policy arguing that “policy bears the essence of the Soviet period which implies the plans on creation of new jobs and labor balanced on almost every level of administrative management”. In particular, before May, 1998, the state ruled the economic units with staff of more than 100 thousand, to create not less 7% jobs for most “susceptible” members of the society. See: UNO (2001). Uzbekistan: Obshaya otsenka strany. p.12

¹²³ The official policy linked the wage increase to the increases in efficiency in proportion of 0,7% wage increase to efficiency increases by 1%.

¹²⁴ UNO (2001). Uzbekistan: Obshaya otsenka strany. The same. p.13

with both agricultural orientation of production, and with the domination of public sector. In 1998 average income in agriculture was equal to 52% of the republican average while average wages in industry was 145%. At that time, the share of agriculture in total GDP declined from 37% in 1991 up to 28% and industry –from 26% to 19% in 1998. On the contrary, the share of services increased from 26% to 42%.

Industrial and investment policy in Uzbekistan had impact on the formation of real wages in the agrarian sector. If in 1990, wages in agriculture exceeded the country's average by 15%, then, in 1994 they were 30% lower than the republic's average. In 1994 agriculture faced 15% decline in average wages, while industry did 5% growth. Even though these figures could be considered as relatively good comparing to those in other former Soviet republics, the population was certainly hit by the decrease on a half of the size of disposable income in 1996 comparing to 1991.¹²⁵

The poverty in transition economies is one of the complex issues. There can be few detailed research on this topic, since most of literature refers to lack of data as well as to the variances and difficulties of a methodological character to conduct an objective assessment. Therefore, available data allow only indirect calculations and social polls conducted by government and non-government organisations.

The priorities of social policy in Uzbekistan are based on the attempts to avoid sharp income differentiation in the society. In spite of the fact that the Gini's coefficient, which has to show differentiation between the richest and the poorest parts of the society had increased from 0,026 to 0,032 in 1989-1996, it was still lower than corresponding indicators in other republics.¹²⁶ Available data on the share of poor people in total population also look better than in other republics.¹²⁷

At the same time, the Ministry of Labor estimated that in 1996, 14% of the total population were living below the official poverty line, calculated on the basis of monthly minimum wage of 750 sums, or \$12 at the official exchange rate¹²⁸. Other researchers suggest that “the poor people in Uzbekistan are those who have the lowest income and want, but unable to improve material well-being by their own”.¹²⁹ For example, in 1991, according to some assessments, about 75% of population had average per capita income lower the value of consumer basket.

¹²⁵ The same. p.13.

¹²⁶ For comparison: in Kazakhstan the coefficient changed by 1,2 times; in Turkmenistan – less than 2 times; Kyrgyzstan – almost 7 times higher. See Central Asia 2010. UNDP HDR 1999

¹²⁷ UNDP (1999). Uzbekistan. Human Development Report. p.26

¹²⁸ IMF (1999) Republic of Uzbekistan: Recent Economic Developments in 1998-1999. IMF Staff Country Report. p.5

¹²⁹ UNDP (1999). Uzbekistan. Human Development Report.

In 1996, some social polls revealed the share of poor and extremely poor groups of population in the republic to be equal to 27,6%. Some regional observations of employment, income and poverty in Namangan, Djizakh, Surkhandarya, Republic of Karakalpakstan concluded that the low-income regions cover about 45,6% of such groups. Given that these were the regions with agricultural specialization, one may expect these two groups to be the families living in rural areas. In the industrialized regions, such groups were significantly less – about 18%.¹³⁰

2.3.4. Structural Changes and SMB

Uzbekistan was relatively successful in dealing with privatisation and denationalisation at the initial stages when privatisation of small- and medium-scale enterprises was actually finished. As of April 1, 2001, the official statistics shows 186 thousand of small- and medium size enterprises are registered. If in 1992 the agrarian sector of the economy included 5,9 thousand farms, in 1993 – 7,2 thousand, in 1995 – 17,1 thousand, then by 2000 – it was already 43,8 thousand, including 38334 dealing with cultivation and 5425 – cattle-farming. From 1991 to 2000 the share of the non-governmental sector in output considerably increased: in industrial output – from 10% to 65,4%; in agriculture – from 66% to 99%; in capital investments – from 34,4% to 34,6%; in construction – from 7,6% to 81,2%; retail trade – from 52,5% to 96,8%; services – from 14% to 57,1%.¹³¹

Nevertheless, some negative affects of structural changes was also observed. The basic problem in many cases was that these shifts looked superficial. While changing the structures and names, the privatized enterprises were by substance retaining old management. As workers were formally given wider possibilities to influence the company's administration and the decision-making process, it was director who was actually reserved his substantial influence in the company, while ordinary stock-holders were given no real power. In addition, privatisation and denationalisation failed to suggest efficient price mechanisms to give state property its real value. In such situation some enterprises might have been sold at lower prices than they might potentially cost. Moreover, lack of active public advertisement, especially to potential foreign investors, led the process to slow-down. Thirdly, in privatized enterprises new owners were reluctant to carry out technical modernisation of production process as it

¹³⁰ The same. p.32. Besides, international organizations such as the UNDP, UNO, World Bank indicate on methodological insufficiencies when estimating poverty in Uzbekistan. The government methodology is based on nominal minimum wage as a basis for the calculation of poverty. However, real minimum wage has been on downward trend which is not taken into consideration. Since “decreasing level of public healthcare and education, reductions of privileges, as well as higher prices on foodstuff, and vague situation with jobs are not taken into account, there is little doubt that they would expand poverty”. See: UNO (2001). Uzbekistan: Obshaya otsenka strany. p.15. According to the data from the World Bank, in 1999 about 30% of population lived below the poverty line. See: www.worldbank.org, country data.

¹³¹ Magazine *Ekonomicheskoye obozreniye*. 2001. No 8-9. p.16

was expected before privatisation. On the contrary, though the state helped the enterprises import necessary technological equipment to improve production process, this process saw a faint pattern.¹³² Fourthly, in terms of worsening macroeconomic conditions in 1997, and subsequent real income decline, possibilities for private investments were restrained. As a result, out of 8,68 mln. employees, only 1/12 (700 thousand) had acquired shares of domestic enterprises. Finally, privatisation of large state-owned enterprises, still needs to be fulfilled. In 1998 only 23% was privatised, as business environment itself was deteriorating.¹³³

The non-state sector in Uzbekistan included not only private enterprises, but also those with substantial state equity holdings. This gave the government an exclusive control over the enterprises and diminished the attractiveness of such enterprises to foreign investors. In 1998, non-state economic entities accounted for 89% of total legal entities, including 45% private.¹³⁴

Since the state continued using state procurements for almost all agricultural products for a while, it restricted the establishment of various forms of ownership in agriculture. In addition, the process itself seemed to remain relatively superficial. Qualitatively, the agricultural departments of local municipalities were rather bureaucratic units which under the existing regime forced to require state plans. The President of Uzbekistan noticed in this regard that *“the most important problem the republic faced was formalism and deception and superficial attitude towards works. Most of the local leaders simply did not understand why the transformation and new property rights were introduced. In many cases the distribution of land to farmers did not take place at all, local khokimiyats (authorities) and kolkhoz directors took the land for themselves”*.¹³⁵ Social polls among entrepreneurs has discovered that land and housing problems were of the highest priorities to introduce real property rights in agriculture.¹³⁶

Despite the government support provided to the SMB, a number of key problems still have to be solved. The entrepreneurs notice that much remains to be done, so that to improve business

¹³² In 1997, 13,9% of the observed enterprises possessed the supplied, but not installed equipment in their warehouses with total value of 5,9 bln.sums, including that of \$70,8 mln.USD which came from abroad. In 1998, 10,6% of enterprises had “not-installed and not-used in production process” equipment which was even higher – 8,1 bln.sums and \$51,1 mln.USD. Most of such equipment was imported through government channels and under commercial credit lines which have to be returned. Tukhliyev N., Taksanov A. (2000) Natsionalnaya ekonomicheskaya model Uzbekistana. Tashkent. p.112

¹³³ IMF (2000) Republic of Uzbekistan: Recent Economic Developments. IMF Staff Country Report. No 00/36. p.32

¹³⁴ The same. p.13

¹³⁵ The quotation is referred to in Wöhrmann F. (2000) Economic Discourse in Uzbekistan. The Perception of Economic Change between Market Principles and Social Traditions. Veilag für Entwicklungspolitik, Saarbrücken. Bochum. p.106

¹³⁶ UNO (2001). Uzbekistan: Obshaya otsenka strany. p.17

environment in Uzbekistan. They still indicate on the imperfection of domestic legislation which is differently treated by executive state bodies that gives a basis to interfere in private sector activities, in many cases, without sufficient reasons breaching the rights of private entrepreneurs. Although the number of state-led inspections decreased significantly, such interventions are considered by businessmen as still being the often case.¹³⁷

Another problem is limited access to financial resources by the SMB. It is rather difficult to obtain funds to start up the business. The procedure itself, including the requirements from a bank for necessary documentation is rather complicated. The banks themselves are reluctant to finance SMB, as they are concerned about the solvency and reputation of private entrepreneurs.¹³⁸ In many cases, entrepreneurs misinterpret the concept of business culture and still have lack of experience, skills and knowledge even after the decade of new relations in the economy. Therefore, along with the improvement in the business environment, it is strongly required to provide wide training opportunities for young entrepreneurs to improve their professional experience and skills.

2.3.5. Challenges in the Financial Sector

The mechanisms according to which money, finance and investments are allocated, is one of the key elements in reorientation of the economy away from plan system to market relations. From this viewpoint, development of the financial sector in Uzbekistan is important in considering two sets of issues. On the one hand, during the years of independence the previous banking system monopolized by the only State Bank was destroyed, and at the same time two-tier banking, with the Central Bank at the head and a network of commercial banks, was created. A number of legal documents such as the laws “On Central Bank”, “On Banks and Banking Activities” developed in accordance with Western models, were also enacted. Besides, the Association of Commercial Banks, the Banking and Finance Academy, the Regional Banking Center and most recently the Institute on Studies of the Banking Sector Problems, were set up to provide comprehensive infrastructure assistance for the development of banks and other financial institutions in the republic.

On the other hand, the whole system of commercial banks itself does not function at full capacities so far, in line with market conditions. It could be explained by a number of

¹³⁷ International Financial Corporation/World Bank Small and Medium Size Enterprises Survey for Uzbekistan, 2003, <http://www.ifc.org/centralasia>

¹³⁸ As an example, the Business Fund which was found to support private entrepreneurship had to be stopped and reconsider the system of credits lending, because only a small part of the credits disbursed by the Fund in 1993 and 1994 had been serviced and eventually repaid. Some credits were even used by entrepreneurs for other purposes than those in agreements. That was resulted in tightening credit procedures as a whole.

problems at the macro- and micro-level which directly influences its progress. First of all, this includes the new principles of interrelations between state and commercial banks, the necessity of further liberalisation of the banking system. Government has currently its equities in almost all banks that allows to take a close look at all banking activities. In such a way, the state tries to reach its macroeconomic goals and carry out programs of overall economic development. For instance, to pursue restrictive monetary policy and keep up inflation low, the state sought to control the lending process and interest rates on credits.¹³⁹ Central Bank's credit rate and bank reserves with Central Bank were then promoting increase in interest rates on credits of commercial banks.

Secondly, commercial banks served as one of the principal tools to pursue state-led industrial policy. A number of specialized commercial banks were founded to finance concrete economic sectors, industrial branches and individual state-owned enterprises in accordance with government priorities (ASAKA-bank for car industry, Pakhta and Galla banks – for servicing the agricultural sector; the National bank for foreign economic activity – for operations in the foreign sector). As a result, such policy caused the situation when most part of credits (about 85% in 1999) was allocated to the government sector in comparison with only 15% credits was directed to private sector on real market basis.¹⁴⁰ Moreover, very often credits to state owned enterprises were converted into government subsidies and subsequently written off.

The banking sector was also heavily dependent on foreign exchange and tax regimes. Under the system of substantial supervision and regulation, banks had to function as tax bodies to collect budget revenues, as well as monitor foreign exchange inflows and outflows through the accounts of their clients. Since tax collection and foreign exchange regulation was carried out on the basis of information made available to the government by the banks, there were poor private incentives to conduct economic transactions through the bank system.

Consequently, some general conclusions for the sector could be drawn. The share of credits of commercial banks in total capital investments either remained at the same level for many years, or even decreased (1996 – 7,5%, 1997 – 7,2%, 1998 – 6,2%).¹⁴¹ Among all credit resources (including centralised credits, foreign credits, credits from various funds, and funds of enterprises), those from commercial banks were the smallest pointing to a passive role of

¹³⁹ According to directives, in 1999 in order to get credit from banks it was necessary to provide mortgage which ought to cover 80% of credit value.

¹⁴⁰ Wöhrmann F. (2000) Economic Discourse in Uzbekistan. The Perception of Economic Change between Market Principles and Social Traditions. Veilag für Entwicklungspolitik, Saarbrücken. Bochum. p.130.

¹⁴¹ UNDP (1999). Uzbekistan. Human Development Report.

banking system in the economy. Secondly, because of state control over interest rates on bank lending, and since it was a usual case to write off substantial part of commercial credits in favor of inefficient state-owned enterprise, real interest rates were negative and therefore, reflected losses for commercial banks. On the other hand, negative interest rates discouraged domestic savings and long-term investment policy from banks (in 1998 about 80% of credits were allocated short-term basis). The private sector, including population, also regarded the banking sector as less lucrative among their investment alternatives, and tried to find other opportunities to invest money in more profitable sources of income (in foreign currency – in the cities, in live-stock – in rural areas, etc.).

The third factor is that access to hard cash on the accounts with commercial banks was limited. Cash withdrawals were permitted only to pay wages. Due to an emerging gap between cash transactions market and bank settlements, the outflow of money from the banking sector increased. Money velocity accelerated that exerted subsequent pressure on the markets of goods and services. Population confidence in the domestic financial system thus remained low.

But, it still remains crucial to complete the restructuring of banking sector property, accelerate privatisation and development of competition. Since the state holds rather high equities in total capital of the banking sector, the attractiveness of commercial banks for private investors, especially for foreigners, is relatively low. Moreover, the support of specialized commercial banks by the state only result in exacerbating monopolistic and oligopolistic trends which undermine the development of competition. With only 30 commercial banks in 2004, the whole banking capital is usually concentrated in 4-5 specialized banks servicing the government-prioritised sectors. In such terms, foreign credit institutions (international, governmental and non-governmental), as a rule, try to obtain the government guarantees for the allocated resources and prefer to work with the same (2-3) commercial banks, while the smaller ones remain always out of the benefits of such cooperation. In this respect, the forthcoming privatisation of the largest domestic commercial banks (ASAKA and National Banks) during 2004-2006 is crucial. Supported by World Bank and EBRD this would promote the process of deregulation in the banking sector, and stimulate further progress to raise attractiveness of commercial banks in the eyes of foreign investors.

2.3.6. Availability of Data and Statistics

In terms of transition, access to objective data on the domestic economic trends is of particular importance. It is crucial for the state itself to provide transparency of the pursued policy for economic entities and population. Uzbekistan declared about irreversibility of market reforms and close cooperation with the world community. One of the steps on this direction is to create appropriate opportunities for domestic and foreign investors which need a clear vision of state intentions about domestic reforms. That is important to keep their own business and investment plans and activities in pace with national development strategy.

One of such elements to be pointed out is the national accounts system. The latter is quite different in the plan economy and market system. However, during transition period, even true market methods of statistical analysis are not fully acceptable. Official statistics in Uzbekistan is unable so far to cover all economic processes as well as to explain a number of factors which in terms of market and transition economies may give controversial results.¹⁴²

There could be a few explanations for this. Partly it may occur due to the retention by national statistics the use of the formerly used tools to assess economic activities. Also there might be still the cases when some economic units, especially state-owned, are still not reluctant to counterfeit figures with the attempts both to hide inefficiency of their activities and/or evade taxation. If so, inauthentic or patchy figures may lay the basis for proliferation of speculations on lack of transparency in government policy, increase the extent of opaqueness, and hence, weaken investment attractiveness of the country in the international business circles.

For that reason, the adoption of national law „On National Statistics“ at the December 2002 meeting of the parliament was critical. It provides a legal basis for more comprehensive access to information and economic data by domestic and foreign economic agencies and investors. It will also imply a step on the way of making domestic economy more open to the world economic community. Moreover, economic entities themselves should be not only just participants of a data collection process, but also immediate consumers of such data which would help them draw up their activities alongside government economic programs and priorities. Subsequently, as more market-based instruments to collect, assess and analyse economic processes will improve, then the state may be capable of developing its forecasts in

¹⁴² Partly because of the differences in methodological approach, the data provided by official statistics and that of international institutions may differ. For instance, consumer price index as an estimation of inflation provided by national statistics was 28% in 1997 and 18% in 1998, while the IMF and the World Bank estimates were 50% and 25%, respectively. The official statistics claimed that Uzbekistan's GDP grew by 5,2% in 1997 and 4,4% in 1998, while other estimates showed 2,4% and 3,4%, respectively. IMF (2000) Republic of Uzbekistan: Recent Economic Developments. IMF Staff Country Report. No 00/36.

close cooperation with private sector by taking into account their immediate needs, opportunities and problems. It will allow to design a more realistic prognosis with keeping in mind the potential factors to influence on the domestic economy, so that then to be more realistic and successful in pursuing further reforms.

2.3.7. The Staff Monitored Program of the IMF

For the domestic reforms, Uzbekistan was granted financial support from international financial institutions, mainly at the initial stages. But the scope of such assistance was relatively insignificant in comparison with other transition economies. The main reasons for this were both the reluctance to make large external borrowings, and the divergences over the path and nature of the reforms between national government and multilateral institutions.

From 1995 the government's stabilization program had been receiving financial assistance from the IMF under the Systemic Transformation Facility (STF) and Standby Arrangement were also approved in December, 1995. However, both lines were suspended in autumn 1996 when the government restricted operations with foreign exchange trying to avoid currency outflow. But later, Uzbekistan had to make a few foreign borrowings on the commercial basis for 1997-1998, so that to keep up internal investments opportunities of local enterprises. Further international and technical assistance was limited to the concrete projects in various economic sectors (agriculture, trade, transport infrastructure, training of government officials).

The April 1999 parliamentary speech of the Uzbek President outlined the intentions of the government to accelerate market reforms through comprehensive liberalisation and deregulation in the economy. To a certain degree, it implied the readiness to renew strongly required negotiations with international financial organisations, so that to acquire their support for the policy which was carried out in Uzbekistan. Since that, the government had reiterated its efforts to introduce current account convertibility and subsequently improve trade regime as a preparatory stage for membership in the World Trade Organisation.¹⁴³

As a preliminary step, the government developed, in consultations with the IMF, the Memorandum on Economic and Financial Policies for 2002 which is part of Staff Monitored

¹⁴³ Uzbekistan was granted an observer status in GATT (General Agreement on Tariffs and Trade, from 1995 - WTO) in 1994.

Programs suggested by the IMF to transition and developing economies.¹⁴⁴ The implementation of the given Program was monitored by the IMF staff during 2002-2003.

By substance, it was a program of concrete measures to be undertaken to lift some restrictions in domestic economy and intensify the reforms. First of all, it required Uzbekistan to meet certain macroeconomic parameters, so that to be assured of serious steps on market-oriented reforms. In terms of limited domestic resources to boost economy, there was a perceived exigency in Uzbekistan to attract additional financial funds from abroad and, therefore, agrees to accept standard conditions of the IMF on economic policies in agriculture, the foreign sector, monetary and fiscal areas. Yet political implications of this collaboration could be seen in a goodwill of national government to back up global trends on liberalisation and in turn to benefit from appropriate support for its domestic policies. The cornerstone of the obligations stipulated by the Program was to introduce current account convertibility and eliminate multiple exchange rate causing the economic distortions among domestic sectors. In this respect, the government committed to move gradually to reach these goals. In line with the conditions of the Program, the government liberalized its foreign exchange regime.¹⁴⁵ In the trade area export bans on a number of goods was steadily decreased to 3 items in 2003, and removed 20 items of goods from the list for which the allocation of foreign exchange was not recommended.

At the same time the government issued two degrees to reform the government procurement system in the agrarian sector. Starting with 2002-harvest, 50% of grain and cotton produced could be freely disposed by farmers at their discretion, while the other 50% of each of items would be sold to the state at regional commodity prices for grain and at world market price for cotton. Moreover, in fiscal and monetary areas the government started with the liberalisation in the banking sector and price regulation.

During 2002-2003 period, the IMF staff delegation headed by E. von Vryer, Head of IMF department for East Europe and CIS countries, visited Uzbekistan a few times to assess the results of the stabilization policies pursued by the government within cooperation of the republic with the IMF. It was stressed that significant changes took place in the economy during the year 2002 and the republic had succeeded in many areas foreseen in the

¹⁴⁴ The document was signed by the key economic officials (Deputy Prime Minister on Macroeconomic Issues, Minister of Finance, Chairman of Central Bank), and published both in national press (see *Biznes Vestnik Vostoka* newspaper, 14 February, 2002) and in IMF's official website on request of the Uzbek government. In such a way, the government tried to display publicly its strong adherence to reforms and cooperation with international financial community.

¹⁴⁵ Since October 15, 2003 all the restrictions on current account convertibility have been officially eliminated.

stabilisation program. However, he also stressed that more decisive steps should be done by the government to bolster closer cooperation with the IMF, alluding to the fact that the main pre-requisite for such relations (“de-facto” current account convertibility) had been still not achieved. It was expected that the subsequent years would require further actions and consultations on this issue between the government and the IMF. In turn, the government hopes that the progress made by Uzbekistan in the implementation of the programme, will give financial institutions and bilateral creditors a better basis to provide financial assistance to the republic.¹⁴⁶

2.4. Summary

In sum, all the post-Soviet states were in relatively worse conditions to start with economic reforms than countries of East and Central Europe, for example. The crisis in the USSR was exacerbated in the early 1970s, and had become more evident by the 1990s. It manifested widely in a production decline, state budget imbalances, hyperinflation and low investment activities in all the Soviet republics after the declarations of state independence. Uzbekistan was to be confronted with a handful of specific problems exacerbated too by the legacy of social and economic shortcomings of the former system. Socio-political and economic situation in the country in the 1990s was dominated by general opaqueness and fragility. This was particularly reflected in the low standard of living of population because of abrupt reduction in real wages, social insurance and pensions; in income differentials and unemployment; and in the shortage of essential consumer goods. Against this background, the republic preceded by the threats of social destabilisation through the growth of criminality, drugs business, terrorism, extremism, bribery among government officials.

For the aforementioned reasons, but also due to the institutional shortages, Uzbekistan embarked on the way of gradual and state-led market-oriented reforms. After almost a decade and half of independent development there is no common conclusion among economists on whether the rejected big-bang strategy could have been a more success and thus brought better economic benefits in domestic conditions than the adopted gradualism. Yet it is obvious that the government was desperately keen in political and macroeconomic stability during the first phase of transformation process, and most likely was loath to challenge the former by following even more popular and seemingly well-grounded and sweeping measures on economic adjustment. The policy started with setting up legal base for institutional and

¹⁴⁶ See the letter of the government of Uzbekistan to Mr.Horst Kohler, Managing Director of IMF, www.imf.org

structural reforms. As the next stage, the state put an emphasis on import-substitution development (energy, agriculture), to reinforce acquired political independence, reduce dependence on the food and energy supplies from outside, and implement large-scale industrial projects. Since 2000, Uzbekistan has been committing itself to comprehensive liberalization. But large-scale restructuring and privatisation, the consequences of tough monetary, fiscal and foreign exchange policies in the past will require substantial changes in production processes and redistribution of income and resources among the branches of the economy. The economic growth may therefore slow down and require some time for the economic recovery in terms of more marketable conditions.

In general, the policy measures in the past recorded success in achieving stated goals, but equally faced some objective controversies. It is worth noting that to tackle the multi-edged development tasks may be consistent with additional costs, while political benefits in particular are not always optimum placed from the economic perspective. For the most part of the former development, Uzbekistan was not a large beneficiary of multilateral financial assistance comparing to other CIS states, due to the disagreements over the pace and scale of local reforms. In terms of domestic financial constraints and unfavorable world prices on the main country's exports, however, the republic was to make resort to basically commercial foreign borrowings. The lion part of these funds was attracted to implement large-scale industrial projects which foresaw the solution of not only purely economic tasks. The domestic energy sector was an evidence of such policy targets. The issue of its specific contribution to the reinforcement of political independence and sustainable development, both in the past decade and in the years to come, is taken up in the next chapter.

Chapter III. THE ENERGY SPHERE IN THE CONTEXT OF NATIONAL DEVELOPMENT IN UZBEKISTAN

3.1. The Energy Sphere as Integral Part of the Development Strategy

3.1.1. National Priorities in the Energy Sector After the Independence

*“It is well-known that the economic prospects of any state are to a significant degree determined by the availability of its own energy resources”.*¹⁴⁷

Since 1991 the fuel and energy complex of the republic has experienced substantial changes. It took one of the central places in the overall strategy of the reforms during transition to a market economy. By looking through some key works of the President I.Karimov to discuss the debates on economic reforms and prospective development in Uzbekistan, one may notice, how often a particular attention is paid to the role of the fuel and energy complex in this respect. What could stay behind these considerations? Why did the energy sphere become target priority for domestic investment after independence? Why was it so critical to place an emphasis on the development of domestic natural base and how was it implemented?

Better understanding of this issue will require from us to take a short look back at the Soviet past again. As mentioned, specialization of the republics played a significant role in the whole division of labor in the planned economy. I.Karimov writes: *“...In such a system all matters, i.e. which region has to produce raw materials, which region should process them, and where finally these products are to be exported, was already pre-determined. Uzbekistan was supposed to be a supplier of cotton, gas, gold, non-ferrous and rare metals, fruits and vegetables... In other words, the role of Uzbekistan in such a closed system was so strongly defined that it was merely unable to leave it”.*¹⁴⁸

The Soviet policy imposed a strict control on main enterprises which were critical in Union's terms, while the republic was left with those economic areas only which could not *de facto* provide its economic sovereignty. Natural gas produced in Uzbekistan was supposed to meet both the domestic and exports needs. Among the consumers of Uzbek gas were largely the republics of the Central Asian region (Kazakhstan, Kyrgyzstan, Tadjikistan), but also Russia and Ukraine. The existing gas pipeline from Bukhara to Russian Ural made it possible to transport gas to Siberia, while Turkmen and Uzbek gas were piped towards Saratov and

¹⁴⁷ Translated by the author from I.Karimov (1997) Uzbekiston XXI asr bosagasida: havfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.633.

¹⁴⁸ Translated by the author from I.Karimov (1993) Uzbekiston – bozor munosabatlariga otishning oziga xos yuli. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.363.

linked to the Russian gas pipeline system. Since the domestic gas producing sector in Uzbekistan was relatively developed in the Soviet times, most industries consumed mainly natural gas, with less share of other energy resources. Contrary to that, the population, especially in rural areas, mostly used coal for domestic heating, as the gas pipeline system in the residential sector was almost undeveloped.

As regards the oil and oil products, their most part was imported from other republics. The Centre was reluctant to invest into the development and exploration of region's oil fields, which came as a result of the highly centralised system of management in relations with peripheries in the planned economy, as well as because of the availability of large-scale energy projects in Siberia. Yet throughout the entire period of the existence of the USSR the central authorities in Moscow might also have had keen interest in retaining key aspects of development under direct control in order to avoid any possibility for the region to become self-sufficient and therefore be less dependent on the Centre and its decisions, although this had been never recognized by Soviet planners. In this sense, oil imports came mainly through the pipeline starting in Russian Omsk and going through Kazakhstan (Pavlodar and Chimkent) to Ferghana Valley, and with Turkmenistan as a final destination. In the early 1990s, energy resources were the second largest tradable product which amounted to 14,8% of total export and 25,5% of total import of oil, gas and by-products.¹⁴⁹ Against the background of total trade deficit, the republic recorded a deficit in trade with energy resources too which thus made the republic substantially bound on external energy supplies, especially on the oil imports. In particular, in the second half of the 1980s, the republic imported about 5,5 mln.tons of oil and oil products with that figure peaking at more than 9 mln.tons in 1991, while domestic production being at about 2,8 mln.tons in the last years of the USSR.¹⁵⁰

In this regard, the question of what was behind domestic policy decisions to channel huge investments into the energy sector in the post-Soviet time needs to be scrutinised in a broader context of political and economic implications.

The idea of oil self-sufficiency became a dominating national priority in Uzbekistan very soon after the declaration of independence. The President I.Karimov wrote that *“one of the main priorities of the first phase of economic reforms was to ensure speeding up the fuel and energy complex's development, increasing oil and gas extraction. And in such a way, to*

¹⁴⁹ Magazine *Economicheskoye obozreniye*. No 8-9, 2001.

¹⁵⁰ In the early 1990s, the republic remained net importer of coal and oil and oil products, while being net exporter of some amounts of gas and electricity. The net import for these products in 1990 was equal to 0.6, 9.5, -3.0 and -0.5 tons of oil equivalent, respectively, with total net import amounting to 6.6 toe. See also: Energy data bank of the ECO secretariat at: http://ecosecretariat.org/ftproot/Publications/EnergyDataBook/Energy_Databank/Uzbekistan/uzbekhstan.xls.

safeguard energy independence of the republic".¹⁵¹ Further according to him, through active government investment policy in the energy sector, one could reach a few, primarily economic results. First of all, the necessity of deep structural changes in the economy was reiterated with the energy sector having been assigned a critical role in the reforms. The Uzbek President noted that *"it was very important to determine key links like oil and oil independence, as well as fundamental industries which could stimulate sustainable growth in the entire economy"*.¹⁵²

Secondly, such a policy entailed the rational use of foreign exchange by reducing the amounts of the imported oil. On the other hand, the development of hydrocarbons export could give an additional source of foreign exchange. The energy complex was one of the first spheres in which import-substitution strategy had been applied.

Thirdly, in terms of successful reforms, energy resources are critical for perspective industrialization of the country.

Fourthly, during the Soviet period Uzbekistan had experienced high dependency on imported raw materials, consumer goods, technology which were yet in shortage in the republic. From this point of view, *"the reduction of the economy's resource-oriented bias and the elimination of one-sided specialization of the economic structure as a result of monopolistic policy of the Centre... has the decisive significance"*.¹⁵³

Similarly this issue was not of purely economic significance. The sweeping political events on the Soviet arena in the early 1990s could not have influencing the inter-republican relations. According to the President I.Karimov, economic transformation in Uzbekistan at that time was to be seen as integral part of a big national political agenda. Speaking about the results of the first phase of economic reforms (1991-1995), he specifically noted: *"At former times we imported 4 mln.tonnes of oil. At present this import has been decreasing from year to year... This is not only economic, but also a big political task"*.¹⁵⁴

A couple of years later, these discourses took an even more explicit form being then linked to the domestic national security tasks too. In particular, among the rhetoric debates on the necessity of stable transformation process in the frame of a new economic security concept in

¹⁵¹ Our translation from I.Karimov (1995) „Iqtisodiy islohotlarni chuqurlashtirich yolida“. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.192.

¹⁵² Translated by the author from I.Karimov (1995) „Iqtisodiy islohotlarni chuqurlashtirich yolida“. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.355.

¹⁵³ Translated by the author from I.Karimov (1992) Uzbekiston oz istiqloq va tarraqiyot yoli. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.14.

¹⁵⁴ Translated by the author from I.Karimov (1995) „Iqtisodiy islohotlarni chuqurlashtirich yolida“. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.320.

1990s, they could be seen as another effort to reinforce various aspects of just acquired independence: *“Despite favorable climatic conditions, we imported sugar, milk ..., grain, meat, potatoes, spirt. Could this meet our requirements for national security ? We had even to import such primary consumer goods of daily use, like matches and salt.*

Therefore, domestic production of strongly needed goods (and resources) is an important task in ensuring national security, sustainability and stability on the whole. This task bears both, economic and political meaning”.¹⁵⁵

In one row with a national task to localize production of consumer goods in the years of independence, Uzbekistan placed an emphasis on import-substitution energy policy too. In Soviet time Uzbekistan was part of common transport and energy system. But after the collapse of the USSR, this system could hardly work as stable as before. On the one hand, Uzbekistan, being located in the centre of Central Asia, was linking the republics to each other. On the other hand, such a geographical location made the republic itself directly dependent on both the Russian energy resources, and on territories, the resources had to cross before reaching Uzbekistan. Against the background of political instability across the whole post-Soviet space, it was hard to rely on prudent economic and political relations between the states. Russia continued to supply energy products to the entire region, like to other ex-Soviet republics for some time after the collapse of the USSR. Yet, with prices for energy products in Russia moving towards the world level and in terms of growing claims to pay in cash for the products supplied, it became hard for importers to meet both of these conditions. Other suggested schemes of inter-republican trade, such as barter, could be even less negotiable due to the presence of inadequate price mechanism and the politicization of trade.

Uzbekistan was then strongly reluctant to be involved in any political blackmail which could arise spillover effect on the domestic political situation by declaring *“mutual advantageous cooperation with any state in the world”*. The President I.Karimov characterises this principle by saying that it is necessary *“to take into consideration mutual interests drawing from own national interests. We do not want to find ourselves under the influence of any other state again. Uzbekistan has acquired its independence not for that to pass it over again to anyone else”*.¹⁵⁶

¹⁵⁵ Translated by the author from I.Karimov (1997) Uzbekiston XXI asr bosagasida: havfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.582.

¹⁵⁶ Translated by the author from I.Karimov (1992) Uzbekiston oz istiqlol va taraqqiyot yoli. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.23.

Hence there was an explicit bias towards less import dependency on consumer goods and raw materials, such as oil, construction materials and etc. in the new post-Soviet development strategy in Uzbekistan. Although official discourses regarded domestic macroeconomic stability to be a result of reasonable economic policies through the prioritised use of internal economic resources,¹⁵⁷ those steps might have been an integral part of general actions to strengthen political independence too so that to somehow relieve the possibilities of external, non-economic by substance, pressure on the country. *“Uzbekistan faces the threats of great power chauvinism and aggressive nationalism which among the other purposes intend to limit foreign economic relations of Uzbekistan through the creation of unequal conditions... There are some political groups on the post-Soviet space who are trying to destabilize situation in the region... They recommend to use the tools of the energy and transport blockade against Central Asia... This is a potential threat to the national interests and security of Uzbekistan”*.¹⁵⁸

In this regard, substantial investments were made after the declaration of independence both to discover new oil fields and expand domestic production in Uzbekistan. Subsequent growth in the energy sector was at average rate of 5,5% in the years of independence which mainly came from the increases in oil extraction (by 3,6 times), gas and condensate (over 2 times) and natural gas.¹⁵⁹ By the mid-1990s, production of oil and gas in Uzbekistan had doubled, in 1994 alone – by 40%. Natural gas extraction increased by 5% in 1994. In 1995, production of oil and gas condensate and gas increased on another 37% and 3%, respectively, over the previous year, and totalled 7,6 mln.tons and 48,6 m³, respectively.¹⁶⁰ The national output of petroleum products – gasoline, diesel fuel, oil and lubricants, as well as jet fuel – expanded considerably. This virtually eliminated the need for fuel imports as a primary resource for power generation and consumption in the industrial sector.

Uzbekistan has also ramped up its gas production by nearly 50% since the early 1990s and reached the level of 57,5 bln.m³ in 2003.¹⁶¹ On the contrary, although coal marks the second largest reserves in the region, comparing to oil and gas, its production and consumption have

¹⁵⁷ By the mid-1990s, macroeconomic stabilisation and economic growth in Uzbekistan in 1996 (1,6%) was mainly explained by the continuous supply of domestic resources, primarily energy resources (oil and gas). See in: Uzbekistan. Five Years of Independence: its Own Path of Development. 1996-1997.

¹⁵⁸ I.Karimov (1997) Uzbekiston XXI asr bosog'asida: havfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.467.

¹⁵⁹ See: R.Zakhidov „Mirovye tendentsii proizvodstva i potrebleniya toplivno-energeticheskikh resursov i energetika Uzbekistana (The World's Trends in Fuel and Energy Resources Production and Consumption, and Energy Complex of Uzbekistan)“. Report in the seminar on „The Energy complex of Uzbekistan in XXI century“. Ekonomicheskii Vestnik Uzbekistana, No 4-5, 2001.

¹⁶⁰ See: Uzbekistan. Five Years of Independence: its Own Path of Development. 1996-1997.

¹⁶¹ Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>

faced stable decline since the independence, largely due to shrinking state subsidies within the line of government priorities to gradually change domestic energy consumption in favor of gas, but also due to limited domestic funds to maintain production of all energy resources. The production decline was thus about 40% from 1992 and stood at average 2,5 mln. tons in 2000-2003. (Table 3.1)

Table 3.1. Production of Energy Resources in Uzbekistan, selected years

Production	1980	1990	1998	2000	2002	2003
Oil (mln. tons)	1,33	2,8	8,1	7,5	7,2	7,1
Natural gas (bln. m ³)	na	36,67	54,8	56,4	57,7	57,5
Coal (mln. tons)	5,7	6,4	2,953	2,5	2,7	na
Electricity (mln. kWh)	na	na	45,935	46,457	49,3	49

Source: EIU Uzbekistan Country Report, Uzbekenergo Joint Stock Company, Uzbekneftegaz, ADB, Bisnis

In general, energy policy began to play an important role in Uzbekistan after the independence. It was correlated with the capital-intensive industrialization policy and overall macroeconomic policy on domestic stabilization. National energy policy was expected to close the gap between rising demand on energy and oil products in terms of import-substitution industrialization on the one hand and secure energy supplies on the other hand. Energy supply consisted mainly of energy products and resources imported from other Soviet republics, primarily from Russia. In attempt to hedge the economy against the risk of disruptions in energy supply, Uzbekistan made a stake on the development of local energy resources. Strategically, in terms of socio-economic and political turbulences after the collapse of the USSR, the desired task was implemented which was to minimize negative effects of these events by embarking on the way of the reinforcement of independence and therefore, leaving small space for any external source of potential instability to spread and fuel domestic processes. Against this background, the republic not only reached full self-sufficiency in coal and gas, but also became net energy exporter for the first time in its history in as early as 1994, and tried to further strengthen this position in the subsequent years.

3.1.2. Organization of Decision-Making in the Energy Sector

The whole energy sector and its related institutions are composed of a number companies and institutions which, to various degrees, take part in the decision-making process in the energy sector. They are: the Cabinet of Ministers (the Central government), the Ministry of Finance, the National Oil and Gas Holding company called Uzbekneftegaz (for the hydrocarbon

sector), the Stock Joint Company Uzbekenergo (electricity) and its legal entity Uzbekugol (coal), and other institutions.

The energy sector in general has been considered as a strategically important area by the government from the very outset. For this reason, all critical decisions, as to the industry structure, the form and content of sector regulation, pricing, the corporate structures of operational entities, privatization and private sector participation, including the establishment of joint ventures, investments into the development and exploration of oil and gas fields on the territory of Uzbekistan, are made at the highest level by the President and/or the Fuel and Energy Complex of the Cabinet of Ministers.¹⁶² The implementation of these decisions is delegated further to the respective agencies in the energy sector.

In 1992, the National Corporation of the Oil and Gas industry **Uzbekneftegaz** was set up as a fully government-owned company. Its main task was to preserve the former assortment of its products which involved the development of manufacturing technology for the petroleum products, such as gasoline, oil, lubricants, solvents and jet fuel formerly imported from the Soviet republics. In 1993, Uzbekneftegaz consolidated more than 260 enterprises in the oil, gas and oil refining industry previously submitted to Moscow. By a Presidential decree dated December 11, 1998, the national corporation of the oil and gas industry Uzbekneftegas was converted into the National holding company Uzbekneftegas as a legally founded joint – stock company of a public type, in which the state was to hold 51% of the company’s stock, with the rest 49% due to be sold to strategic investors. Yet the latter remained unrealised because of low attractiveness of the proposed investment package, as well as financial problems around the national company, currently embracing about 80000 workers.

On October 21, 2003 the Cabinet of Ministers took another decision directed on the improvement of the set-up of Uzbekneftegaz in order to increase sustainability and coordination between the oil and gas economic units involved into geological, exploration, transportation, processing and sales of energy products, as well as for better investment credibility.¹⁶³ According to the document, the oil and gas decision-making structure is based on a three-tier vertically integrated system of the respective companies, although the policy-making level includes the highest level and a number of other non-energy state institutions (Annex 3.1). In our case, Uzbekneftegaz, as a first implementation tier company, controls and coordinates the whole activity in oil and gas industry both directly and through five other its

¹⁶² See for example: President Uzbekistana i Glava Gazproma Obsudili Sotrudnichestvo (President of Uzbekistan and the Head of Gazprom Have Discussed Cooperation). www.uza.uz, 23 July 2003

¹⁶³ See the Decree No 460 dated 21 October 2003 “On the Improvement of the Management Structure in the National Holding Company “Uzbekneftegaz”.

sub-units.¹⁶⁴ The middle implementation tier consists of the two sub-levels: upper and lower, both report directly to Uzbekneftegas. The upper level includes the four joint-stock companies with 51% of stock are to be held by Uzbekneftegas, up 10% - for the employees these companies, 39% - for private investors, as well as a newly created general department as a legal entity. They include:

- **Uzgeoburneftegazdobycha** – oil and gas exploration, drilling and production, as well as processing of natural gas and recovery of gas liquids which emerged the reorganized Uzburneftegaz – drilling company;
- **Uztransgaz** – transportation of natural gas;
- **Uznefteprodukt** – oil products sales and distribution, also includes some petrol stations;
- **Uzneftegazmash** – manufacturer of oil and gas equipment.
- **Uzneftegazsvyaz** – general department for maintenance communications network.

The lower level embraces 3 specialized companies, one production complex and the two education institutions, and a specialized journal. In particular, they are:

- ❖ the open-type joint-stock **UzLITneftegas** (25% owned by Uzbekneftegas)
- ❖ the open-type joint stock **Uzvneshneftgaz** – foreign relations;
- ❖ **UzVCh** (company deals with safety and security issues), its stock are fully owned by state, but managed by Uzbekneftegas;
- ❖ the Shurtan gas and chemical complex (the largest gas production unit in the country);
- ❖ the Bukhara college on Oil and Gas Industries, the Ferghana oil college – the two regions with the main Bukhara and Ferghana oil refineries;
- ❖ the Editorial Board of *Oil and Gas in Uzbekistan Magazine*

The lowest-tier subsidiaries are dealing with the construction issues mainly on a regional basis. All of them are open-type joint-stock companies, yet strongly linked with the top level management and control in Tashkent.

This is a new structure developed in close cooperation with an International consortium headed by French Investment Bank BNP Paribas. It has been significantly improved and simplified comparing to the previous one. The number of intermediary units was reduced

¹⁶⁴ If the Cabinet of Ministers were assumed to be the highest level de-facto involved in decision-making, there would be a four-tier system. However, formally the organizational structure is made up of the companies directly involved in the oil and gas industry where Uzbekneftegas is considered to be on the top.

through the mergers and reorganization, making administration in the oil and gas industry more compact and coordinate. In particular, the formerly existed subsidiaries Uzneftepererabotka which embraced refinery companies, and Uzneftegazsnabjeniye which secured food and catering service in the industry, were dissolved and their sub-units were transferred to Uznefteprodukt. Uzneftegazstroy, which was previously responsible for construction, was merged by Uzbekneftegaz itself, while the construction companies came to be reporting directly to Uzbekneftegaz.

Yet, on the whole, the new set-up is still strongly integrated into vertical relationship both between the Central government and energy companies, and inside the energy sector itself. Although almost all the companies in the sector are joint-stock and legally independent, they remain dependent on the main decisions taken by Uzbekneftegaz in that it concerns the supplies of equipment and raw materials, as well as financial injections and loans, including foreign. This thus enables Uzbekneftegaz to keep watch and subsequently retain its interventionary status in regional exploration, production, processing, construction or any other oil and gas related activities throughout the country regardless the level of operation, since no legal framework is known as preventing such activities. In addition, the whole sector itself is seen in terms of natural monopolies whose activities are subject to immediate state regulation.¹⁶⁵ Moreover, the energy sector remain strongly committed to the government after the latter mediated and channeled the huge amounts of foreign credits and loans on the sector's modernization, upgrading, and the construction of new facilities which have all been capital-intensive projects. Since all these borrowings were made under the government's guarantees, the energy sector will most likely be retained under a close state supervision unless these borrowings will be at least all repaid. Nevertheless, the recent decisions has confirmed that in terms of the forthcoming privatization of Uzbekneftegaz, a controlling stake will be held by the government, with 48,7% to be sold to a foreign strategic investor.¹⁶⁶

The picture of the main policy-making institutions in the **power energy field** has much in common with the oil and gas complex (Annex 3.2). In accordance with a President's decree, the Ministry of Power Generation and Electrification which had been found in 1990, was abolished.¹⁶⁷ In attempt to decentralize the energy system, the government set up the State-Joint Stock company "**Uzbekenergo**" to succeed the abolished Ministry, both by its assets

¹⁶⁵ It is especially reflected in energy price policies made not on the sector's level, but on the level of the government with the involvement of other non-energy state bodies (See Annex 3.1). These policies could be most likely explained with the efforts to maintain domestic industrial competitiveness and follow social goals.

¹⁶⁶ Uzbekneftegaz Restructuring Complete. The Times of Central Asia, <http://www.times.kg/news>, 25 June 2004

¹⁶⁷ See the President's decree of February 21, 2001 „On Deepening Economic Reforms in the Energy Sector”.

and commitments. At present, the Uzbekenergo contains the two main fully-owned subsidiaries – the Uzelectroset (transmission system) and the Uzenergosbyt (buyer and seller of power, as well as export); as well as specially new created supervisory body Uzgosenergonadzor to supervise operations in energy sector. There are 15 regional subsidiaries for distribution and sale of energy from Uzbekenergo, 7 thermal plants, 6 hydropower stations, one transmission company. Gradual corporatization and offer of up to 49% of the shares of power and thermal plants to investors has been envisaged.¹⁶⁸

The main tasks of Uzbekenergo are:

- sustainable energy supply in the economy, including the residential sector, regulation and coordination of domestic energy system functioning;
- development of short- and long-term prognosis and programmes for the development of electro and power system and coal industry, development of production and consumption energy balances for the domestic economy;
- investment activities dedicated to the reconstruction, upgrading, modernisation and further development of power generating capacities and electricity grids, as well as coal industry enterprises, including the assistance of foreign investors;
- coordination of coal exploration activities, improvement and introduction of new cost-efficient methods of exploration in coal mines, so that to further increase its share in total energy generating structure;
- development of recoverable and non-traditional sources of energy;
- organization of the development and realization of the measures rational use and energy saving programmes.

Besides, most recently another government authority – the Supervisory Committee over the processes in the energy field Uzgosenergonadzor was also founded. Its main functions are determined as follows:

- development, ratification, and control over the fulfilment of legal documents and rules in the field of production, transportation and consumption of energy and coal;
- development and control over the realization of preventive measures to provide security conditions while producing, transporting, and sale of energy and coal;

¹⁶⁸ In enterprises involved in design, civil works and maintenance the sales of a minimum of 75% has been planned.

- scrutinize the security measures on newly built objects related to the requirements of production, transportation, and consumption of energy;
- licensing energy production on plants connected to the common electricity system.

Yet within these functions Uzbekenergo remains actually highly dependent on central government's decisions, prescriptions and priorities. For instance, Uzbekenergo is hardly able to undertake any sovereign steps without preliminary consultations and approvals from the Cabinet of Ministers. The latter is concerned to preserve its domination in the energy field through retaining a full control in all hydropower plans, the energy networks communications system, and the two aforementioned affiliates of Uzbekenergo. Since the issue of investments into the construction of new plants and the development and expansion of sources of energy is usually debated on the highest level, the direct submission of Uzbekenergo to the Cabinet of Ministers is necessary for the government to keep its influence felt throughout the entire events in the energy sector.

The **coal industry** today is under the supervision of the joint stock company “**Uzbekugol**” (Uzbekcoal) which operates within the structure of Uzbekenergo, but as an independent legal entity. In comparison with oil and gas industry, the role of coal industry has decreased in years of independence. Nevertheless, the government priority is to renew the role of the sphere in the economy. The structure of government monopoly in coal industry faces changes, even though they are undertaken gradually. Most recently, the government has abolished the sales company “Uzbekugol” and transferred its functions to local authorities. By this measure, the state tries to improve overall management in the coal sphere and reduce the number of intermediaries. Moreover, the shares of a few enterprises of coal industry, such as the open stock companies “Informugol”, “Svyazugol”, “Ugolstroy” which are state companies, are suggested to be sold publicly.

At the same time, the government is very cautious with the privatization of the largest coal companies. Partly it is related with the strategic significance of coal industry in the near perspectives¹⁶⁹. Most of coal enterprises possessed huge government stakes. On the other hand, the largest joint stock company “Ugol (Coal)” is governed by the Council of Directors. The chairman and its deputies must be approved by the Cabinet of Ministers before their appointment. Therefore, key positions in management and decision-making are also regulated by the government so far.

¹⁶⁹ See: The National Programme of Coal Industry Development in 2002-2010.

Thus the energy sector's development is currently in the limelight of close government regulation through a number of functions divided between various state bodies. The most important economic function is carried out by the Ministry of Finance which has regulatory responsibility of price setting of all energy forms, while direct insiders, such as Uzgosenergonadzor (electricity), for instance, is in charge of technical supervision only.¹⁷⁰ In addition, many decisions of an operational or commercial nature as to the sphere are regulated or at least subject to approval by the Ministry of Finance, the Anti-Monopoly Committee or directly by the Cabinet of Ministers. As regards privatization issues, decisions are made and implemented by the State Property Committee headed by another Deputy Prime Minister. The State Committee for Nature Protection is in charge for the environmental aspects.

3.1.3. Main Producers in the Energy Sector

According to official sources, about 187 oil and gas fields are discovered at present, including 91 gas and gas condensate fields and 96 oil and gas, oil condensate, and oil fields. The Uzbekneftgaz is engaged into the development of 88 fields, while another 58 are ready for development, nine are held in reserve, and 17 are in geological exploration. There are five main regions with supposedly the largest domestic hydrocarbon reserves. They are: the Ustyurt area, Bukhara-Khiva, South-Western Gissar, the Surkhandarya and Fergana regions.

In 1992, the prospective Mingbulak oil field was discovered in Fergana Valley. However, **the largest oil reserves** were discovered in the Western part of the republic which contains over 60% of Uzbekistan's known oil fields. The Kokdumalak oil field plays a key role in total oil production in the republic today, since it gives about 70% of the country's oil production. The Ferghana Valley, which hosts the newly discovered Mingbulak oil field in Namangan area, accounts for 20%. Moreover, the Ustyurt plateau and the Aral sea (Karakalpakstan) have been targeted for the further exploration. For instance, according to some estimates, the Ustyurt plateau contains 1,7 bln.tonnes of oil and condensate. 14 new oil and gas fields were identified in 2000 – 2003, five of them in Ustyurt region.

¹⁷⁰ The Uzbekneftgaz subsidiaries have to receive approval from the Ministry of Finance for the prices that they charge for their goods and services and, for certain goods and services, have to charge prices that the Cabinet of Ministers establishes. In addition to the exogenous price policies, cash and payments among oil and energy units also remained controlled and supervised by the Ministry of Finance. See: Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003. p.21. The most recent government decision is intended to improve collection of payments in the public utilities sector (PUS) but with simultaneous intervention into price policies. Although the PUS currently is not a formal part of the energy complex, it de facto serves immediate interests of the energy sector in part of sustainable payments, the efficacy of energy use and subsequent modernization of the system. The real impact of this decree is yet to be determined but the government explicitly retains its lever as the last important price maker. See: President Decree on Measures to Prevent Unreasonable Increases in Tariffs and Tightening Responsibilities of Consumers for Timely Payments for Communal Services. Information Agency UzA, 12 February 2005.

Total **probable gas reserves** at the fields are estimated at 5.1 – 6.25 trln.m³, with commercial reserves of 1.62 trln.m³. Foreign experts said the level of commercial gas reserves in Uzbekistan is double that in Britain, Europe's biggest gas producer. Specialists at national holding company Uzbekneftegaz said the country had developed less than 23% of its gas resources. Proven reserves are found in the following five regions: Bukhara-Khiva (73% of potential developed), Gissar (35%), Surkhandarya (11%), Fergana (27%), and Ustyurt (12%). According to Uzbekneftegaz, proven reserves are about 37% worked out. About 40% of the forecast gas potential is found in Bukhara-Khiva gas region. Shurtan field with 400 – 600 bln.m³ forms the basis of the region's hydrocarbon potential.

The Kandym fields with proven geological reserves of 283 bln.m³ of gas and recoverable reserves of about 210 bln.m³ are the most promising in Bukhara-Khiva region. Proven gas reserves at Kandym total 150 bln.m³. Once commercial development begins Kandym will yield 8–10 bln.m³ of gas a year and Khauzak and Shady fields may produce about 3 bln.m³. Recoverable gas reserves at the Kokdumalak field in the same region total 145 bln.m³.

Gissar region has nine oil and gas fields with the majority of gas reserves found at Adamtash field in the Southwest Gissar block. Uzbekneftegaz estimates recoverable reserves at the field of total 35 billion – 55 bln.m³. The Ustyurt region is also promising with potential of 1.7 trln.m³. The 11 blocks cover 105,000 km². Urga, Shagarlyk, and Berdakh are the most promising structures with an estimated 46 bln.m³, 36 bln.m³, and 30 bln.m³, respectively.

The main producer in **coal industry** is the Angren open-cast mine which is alone possesses half of coal reserves, and produces about 80% of total republican coal. However, contemporary problems are seen, that make production low-profitable and inefficient. Capacity utilization of Uzbekistan's mines is rather low, largely because existing equipment which has not been upgraded since 1992, has virtually exhausted its service life. The vital task for the government is to modernise production process, otherwise huge reserves will remain untapped and tiny in total domestic energy consumption.

The other two coal deposits – Shargun and Boysun (the Surkhandarya area) are much smaller than the Angren deposit by both reserves and production capacities. Nevertheless, coal produced in Shargun, for example, is of higher quality, and gives 3 times more energy than brown coal of Angren. Therefore, these two deposits, even being rather small, are also important for the consumers, especially in Surkhandarya region itself, the primary consumers of the Shargun and Boysun coal.

The location of the main producing areas pre-determined the construction of new **oil refinery facilities** after independence, making them easily available for raw oil and condensate supplies. The first most prominent investment project in the energy field within the CIS since Independence was the construction of a new **Bukhara oil refinery** which was put into operation in 1997. The project's cost was amounted to more than \$400 mln. To realize the construction, a consortium was formed which comprised the Technip Company of France, the Japanese companies Marubeni and JGC. As a result of the construction of the first production line, Uzbekistan's processing capacities increased by 2,5 mln.tons of crude oil and condensate. At the same time, Uzbekistan has **two refineries at Ferghana and Alty-Ariq** (the Ferghana Valley) built in the Soviet era. Being one of the largest in Central Asia, Ferghana oil refinery is specialized in the processing of carbonic-hydrogen products, and oriented towards fuel and lubricating oils, while Bukhara oil refinery oriented for gas condensate production. It was designed for high quality and international standard gasoline, diesel oil and aviation kerosine production.

The Alty Ariq oil refinery established in 1906 has been merged with the Ferghana oil refinery plant and became an operational part of the Ferghana refinery. The Ferghana oil refinery was originally constructed to supply oil products locally, as well as to Russia, Kazakhstan, Kyrgyzstan and other republics of the former Soviet Union. It started operations in 1958 with one crude and vacuum unit. It has since grown steadily and now has total crude and condensate capacity of 8,7 mln.tonnes of production annually.

High losses during the refinery process due to out-ofdated equipment in the Ferghana refinery plant urged the government to reconstruct its facilities with the foreign assistance from Eximbank of Japan and EBRD. \$180 mln.loan agreement was used to realise the project. Among others loan proceeds have been used for the construction of a new desulphurisation unit ther to meet the necessary requirements of the domestic market.

In the **gas industry**, Uzbekistan invested more than \$50 mln. in 2001 – 2002 to modernize its exploration facilities under the program. In 2001 the government launched the Shurtan gas and chemical complex (Kashkadarya region) which included installations to clean gas, a natural gas booster compressor station, and a plant with total amount output of 125000 tonnes of polyethylene, 137000 tonnes of liquified gas and 100000 tonnes of light gas condensate.¹⁷¹ This complex, being located near the Shurtan gas fields in the south-western part of Uzbekistan, was completed in December, 2000, at a cost of approximately \$1 bln. A

¹⁷¹ A.Obidov „O razvitii neftegazovoy otrasli Uzbekistana”. Report in the seminar on „The Energy complex of Uzbekistan in XXI century”. Ekonomicheskiy Vestnik Uzbekistana, No 4-5, 2001.

consortium, including Swiss, Japanese and American companies, international financial institutions and the government of Uzbekistan, totalled \$600mln. of foreign investments. The two aforesaid plants are used to extract and convert hydrosulphur from gas and condensate into sulphur. Now it produces about 15 bln.m³ annually, while further plans to increase annual output to 20 bln.m³ are also considered.¹⁷²

In an attempt to develop domestic infrastructure of gas distribution, an underground gas storage facility in Khodjaobod (the Andijan region) was constructed and opened in 1999 at a cost of \$72 mln. The storage allowed to increase gas shipments to Uzbekistan's industrial heartland in the Ferghana Valley. Annually Uzbekistan puts into operation about 100 km of gas pipelines, both to serve industrial and private consumers (the residential sector) that provides sustainable work of the gas complex with the other sectors of economy.

In order to attract foreign investments, the government is seeking to offer about 80 oil and gas fields, both producing and virgin, for prospective investments. Notwithstanding lucrative gas reserves, investors were cautious about the long-term projects. The first large-scale production-sharing agreement was signed in 2001 between the government and the Trinity Energy Group (UK) which committed to invest more than \$400 mln. over a 40-year period in exploration and production of gas condensate deposits in the Ustyurt plateau and South-Western Gissar area.¹⁷³ Besides, Russian companies are also very active. The representatives of Gazprom and Itera have succeeded in negotiating to form a joint venture with Uzbekneftegas for the development of new gas fields in Uzbekistan with the purposes of "increasing gas production, developing the system of gas transportation, attracting investments into the given field, and also privatization natural gas industry of the republic".¹⁷⁴ It resulted in a few gas investments from Russia into gas development in Uzbekistan which will be discussed later.

At the same time Uzbekistan has the best developed **power and energy system** in the entire Central Asian region. "*It is well-known that an economic development of a state depends, to a considerable extent, on its energy base. From this point of view, Uzbekistan has a very strong*

¹⁷² Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>

¹⁷³ A Trinity Energy subsidiary, UzPEC Ltd, invested \$13 million in the oil and gas complex in 2003. UzPEC said the figures received through exploration show the license area may contain gas. Once geological exploration is completed forecast reserves could be increased. UzPEC plans this year to invest more than \$50 million to explore and develop Uzbek fields. It will begin natural gas production in late 2005 and reach the level of 2 bln.m³ in 2006. See: Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>

¹⁷⁴ See „Gazprom and Uzbekneftegas expand cooperation”. www.uza.uz, 18.12.2002

energy system”.¹⁷⁵ The government thus sees “the strong energy system” as an integral positive and equally needed condition in the entire development strategy during transition, whereby the political significance of these words seem no less important than its primarily economic contribution.

Actually, Uzbekistan’s energy system comprises 37 thermal and hydropower plants. The energy system is largely based on Syrdarya, Tashkent, Novo-Angren, Navoi thermal plants. The energy system produces almost half of all power generated by the Central Asian Unified Energy System, the part of which it remains.

“The existing capacities of the energy system will allow to provide with energy all the domestic investments in the nearest future without constructing new electricity-generating capacities”.¹⁷⁶

In fact, that power generating capacities in Uzbekistan increased between 11,4 GW in 1992 to 11,8 GW in 2002 which allowed to steadily increase in both domestic output and consumption (Table 3.2).

Table 3.2. Electric Power Production and Consumption (mln.kWh)

Description	Reported			Forecast	
	1999	2000	2001	2005	2010
Total output:	45372	46457	47070	55000	63000
PS	439333	45487	46100	53700	61700
HPP	38608	40905	41000	48500	55600
HES	5325	4582	5100	5200	6100
BS	1386	950	950	1300	1300
Nuclear	0	0	0	0	0
Total consumption:	46564	47382	47070	55000	63000
Effective	38577	39112	40040	45700	53100
Energy Balance	-1192	-925		-	-

Source: Ministry of Macroeconomic and Statistics of Uzbekistan, *Uzbekenergo Joint-Stock Company*

Note: PS-power stations, HPP-heat power plants, HES-hydroelectric stations, BS-block-stations

Much of Uzbekistan’s electric power is generated from natural gas-powered plants (85%), with smaller amounts generated from coal (5,3%) and hydroelectric facilities.¹⁷⁷ The largest gas-fired plants are Syrdarya (3GW) and Navoi (1,25GW) plants which together account for

¹⁷⁵ Our translation from I.Karimov (1997) *Uzbekiston XXI asr bosagasi: havfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari*. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.633.

¹⁷⁶ Source is the same. p.634

¹⁷⁷ M.Usmanova „Sostoyaniye i perspektivy razvitiya electroenergetiki Uzbekistana (State and Perspectives of Energy Complex Development in Uzbekistan)“. Report in the seminar on „The Energy complex of Uzbekistan in XXI century“. *Ekonomicheskii Vestnik Uzbekistana*, No 4-5, 2001.

one third of all generating capacity of the republic. There have been installed a few power generating units with a capacity of 150-300 kW in each of the plants. Several coal-powered facilities, including the 1,8 GW coal-fired Angren plant, are located near the Angren open-pit mine close to Tashkent. In addition, many hydroelectric plants (the largest being Charvak, with 0,62GW capacity) supply almost 15% of the country's electricity. The infrastructure of energy transmission is the most developed in Central Asia. The length of electricity lines is amount to 233000 km, cable lines – 200000 km which currently allow Uzbekistan to be a leading regional power producer.

At the same time, further investments in energy system are continued. The construction of the largest Talimardjan Regional Power Plant is under way and soon completed. Installed capacity of the power station will be 3,2 GW, four energy units with a capacity of 0,8 GW each. In addition, the investments of \$60 mln. are expected to rebuild the heat and power plant in Mubarek that will increase capacity from 60 MW to 100 MW. This modernisation strategy may thus allow not only to meet domestic demand, but simultaneously foresee the implementation of a number of export initiatives across the region in the future.

3.1.4. Main Consumers of Energy Resources

Since the break-up of the Soviet Union, Uzbekistan is also a large energy resource consumer. In the early 1990s, the republic consumed just over 7 mln.tons, with less than a third of this amount being produced domestically.¹⁷⁸ Since 1998, as it has been mentioned before, domestic needs for oil have been covered by country's own oil supplies.

As for gas, Uzbekistan became self-sufficient in gas in the mid-1980s, while producing some volumes for export too. Consumption of gas has steadily increased along with its production.¹⁷⁹ Currently, gas is the most consumed energy resource in the domestic economy. On the whole, during 1990-2001 period, through the substantial increase in oil and gas production in Uzbekistan, their share in total consumption of energy resources increased by 5,5%. However, the structure of consumption is extremely uneven: 85% for gas and 10% - for oil and oil products. With a domestic policy emphasis on the consumption of relatively cheap

¹⁷⁸ Here it needs to be also stressed that oil consumption fell from 7.4 in 1991 to 4.8 mln.tons of oil equivalent in 1995 due to less consumption in all sectors of the economy. Among macroeconomic challenges (fall in output, GDP), the targeted efforts by the government to shift consumption towards gas (for example, in transport), and partly energy-saving steps could be also noted.

¹⁷⁹ By sector division, total gas consumption increase in 1990-1995 was a result of almost double-fold increase by households, from 6 mln.tons of oil equivalent (toe) to 13.7 mln.toe, while agriculture and industry both saw mainly declining trends. While population benefited from access to low-priced gas as part of social benefits, other sectors suffered from complex general macroeconomic situation.

gas,¹⁸⁰ the share of coal in total consumption decreased substantially – by 3,4 times and reached less than 1%.¹⁸¹

In the regional context, the lion's share of energy produced by Uzbekistan is consumed domestically – about 46 GW per year. Only a tiny part is exported to Kazakhstan and Kyrgyzstan (about 2-3 GW). However, this amount is crucial for Kyrgyzstan and Tadjikistan which fire imported gas to produce energy at domestic thermal power plants. In terms of further economic growth, the demand for energy in the region is expected to increase steadily which is congruous with Uzbekistan's plans to expand export markets, including through increases in energy and gas supplies to its neighbors.

The break-down of energy resources consumption by sector reveals that the industry (25.8%) and household sectors (40.7%) were the largest consumers in 2002.¹⁸² The largest industrial consumers are non-ferrous metallurgy, some chemical industries, the industry of construction materials, and large electro smelters for metals and ceramics, all of which are material- and energy-intensive. Equally the fuel and energy complex itself is a huge consumer of resources. As it has been underlined before, electricity in Uzbekistan is mostly derived from 85% thermal plants which fire natural gas, 10% – oil and 5% - coal as a primary resource. The largest natural gas-powered facilities include the Syrdarya, Tashkent and Navoi plants. The most coal consumer facilities are two power plants in the vicinity of the Angren mine near the capital Tashkent, the larger of them is the Novo-Angren power plant.

The share of final energy consumption by population increased substantially, from 17,7% in 1990 to almost 41% in 2002, which might be explained by the government's intentions to set up a sustainable gas supply network with a wider public access. In particular, the level of gasification in rural areas has doubled (from 25,6% in 1992 to more than 50% in 2003), while in the cities these figures run up to 85%.¹⁸³ Although these figures may reflect the priorities of social orientation in carrying out the reforms, yet the trends may be seen as an outcome of

¹⁸⁰ In 1994-99, domestic price of oil amounted to 20-30% of the world prices (\$20-40 against \$110-160 per ton). Domestic price of gas was equal to 15-25% of the world prices (\$10-25 against \$65-95 per m³) at curb market exchange rate, which was in place due to foreign exchange restrictions. The situation changed little in the beginning of the 2000s. Domestic wholesale and retail prices for gas were counted to be about 23% and 11%, respectively, of its average regional export prices (\$45 per m³), while the wholesale and retail prices for coal - 31% and just over 15%, respectively, in 2001, with average export price \$35 per ton. For statistical data see: Energy Information Administration, www.eia.gov/uzbekistan; Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003, tables in Annex 3.3; see also IMF reports in various years.

¹⁸¹ The decline in domestic coal consumption mainly occurred in the first half of 1990s at the expense of simultaneous decline in all consuming sectors (industry, households, agriculture due to aforementioned reasons.

¹⁸² The other consumers of energy resources in the economy were agriculture (5.8%), transport system (10%), public and commercial services (8.5%). See: IEA Energy Statistics for Uzbekistan in 2002. Available on IEA website at www.iea.org.

¹⁸³ Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>

other processes too. Increase of the residential sector share in total energy consumption of gas, for example, could be equally caused by an increase in population on the one hand, and the relatively lower prices of energy resources in the households sector compared to those in the industrial sector, on the other hand.

Currently Uzbekistan seeks for the rationalization of energy consumption by changing the share of oil, gas and coal in the total consumption structure. Since oil and gas are not renewable resources and tend to be exhausted sooner or later, the need for involvement of coal into the production process is seen by the government as an alternative. Through these measures, it aims to reduce a burden on the oil and gas complex. In particular, it is planned to reduce the gas consumption of power stations and increase the coal-based power output. These measures are expected to improve the fuel balance structure by tripling coal-used portion of the power output from about 5 percent and correspondingly decreasing natural gas consumption from 84 per cent to 71 per cent. Investments of US \$254 million are expected to be channelled into the coal industry in over 10 years period. While Uzbekistan annually produces 2.7 mln. tonnes of coal, its production is expected to increase to 9.4 mln. tonnes after modernization.¹⁸⁴

Further industrial growth and the diversification of energy consumption are due to be in line with the simultaneous energy-saving programmes. The latter are necessary to encourage both the efficient use existing energy resources and total hydrocarbon reserves, as well as for the reduction of a burden on energy-intensive production.

3.1.5. Contemporary Challenges in the Energy Sector

At the same time, the contemporary development of domestic economy has revealed the wide specter of problems exacerbated during transition to a market economy. These difficulties partly inherited from the former planned system, have been especially aggravated during the last years. With the structural changes in the entire fuel and energy balance, growth rates of primary energy resources extraction lags behind domestic energy consumption. For instance, in 1995-2001 total production of energy resources increased by 15,7%, while domestic consumption increased by 18%. It is especially true for local oil and related products. In 2001, the total extraction of energy resources was insignificant, while oil extraction faced a slide by

¹⁸⁴ According to the National Coal Industry Development Programme during 2002- 2010, the measures include construction of the second coal supply line and equipment installation at the Novo-Angren state district power station (SDPS); modernization of the existing coal supply facilities at the Angren SDPS; efficiency increase oriented reconstruction and re-equipment of the power facilities. See also: Mavlany J. Energy Sector of Uzbekistan, Report of 28 November 2003, http://www.bisnis.doc.gov/bisnis/bisdoc/0312UZ_Power.htm

3,7% for the first time in the recent years. Similarly, production decline of oil products, such as heavy oil and diesel, is also observed, although local production capacities are underused.¹⁸⁵

In addition, due to the shifts in national priorities, coal extraction went down from 6,5 to 2,5 mln.tonnes, i.e. by 2,6 times since the early 1990s. As a result, the share of natural gas only in total production and consumption of energy resources is about 85%, with the comparatively smaller volumes of other resources. In such terms, it imposes an extremely high burden on the energy sector, causing its one-sided development in addition to the strong dependency on the exhaustible sources of energy, with the subsequent discrimination of others, including the renewable ones. Not at least the majority of the existing problems originate from the Soviet period, and, as a rule, have much common with the shortages of the former system (See Box in Annex 3.3).

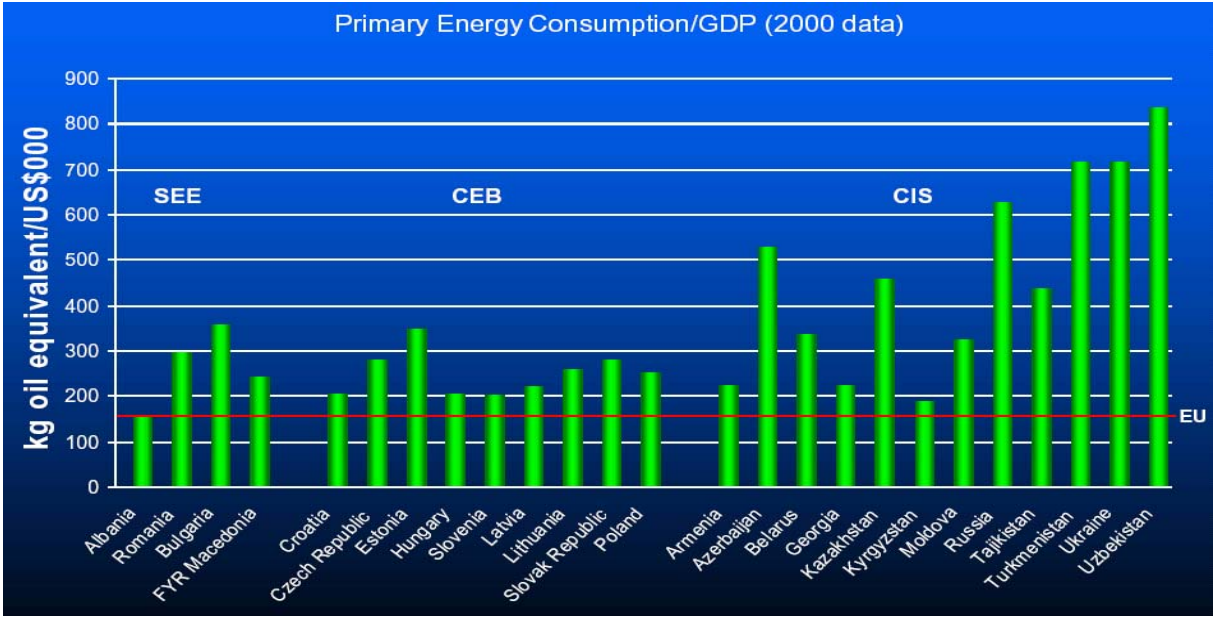
In the given context, a few aspects could be set out to highlight the Uzbekistan's challenges in the energy sector. Despite the steps taken by the government on active technical modernization in the energy production sector since Independence (the construction of the Bukhara refinery and the Shurtan gas and chemical complex, the reconstruction of Ferghana refinery plant), the best part of domestic industry suffers from out-of-date equipment. Most of this equipment has been still used since the Soviet times. That is particularly true for the fuel and energy complex, ferrous metallurgy, chemical and construction materials industry which are the largest consumers of primary energy resources. Being one of the main problems of the Soviet system, the wasteful consumption of energy resources has been still a case during the whole period of independent development of Uzbekistan too. Naturally, while it increases GDP energy intensity and reduces competitiveness of the economy in international framework, this also has negative consequences on vulnerability and national security of the republic. GDP energy intensity in Uzbekistan was 3 times higher than that of industrially developed countries during the 1990s. This trend is attributable to almost all the countries in transition so far, especially to former Soviet republics, even after a decade of sovereign development (Diagram 3.1).

The reasons of this problem could vary from country to country, though some general features are found in almost all former planned economies. In Uzbekistan, many large and middle-scale enterprises, pre-dominantly state-owned, kept their activities after Independence. It is

¹⁸⁵ A total refining capacity of the 3 main refineries in Bukhara, Ferghana and Alty Aryk is about 11,1 mln.tons per year with plans to further increase domestic capacities by another 2,5 mln.tons. Yet in 2002 the refineries refined only 6,1 mln.tons of crude oil and gas condensate, mainly as a result of sliding domestic oil production. See: Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003. p.6.

obvious that they were not prepared to act in new conditions. Despite new economic conditions, most of them retained monopolist nature. Besides, most of the equipment was obsolete, and this all encouraged inefficient use of energy resources. In such terms, they did not have neither sufficient resources nor incentives to improve energy consumption.

Diagram 3.1 Comparative Data on Energy Intensity in Central Asia and Developed Economies¹⁸⁶



Source: Energy Intensity in EBRD’s main regions, <http://ebrd.org/country/sector/energyef/about/energy.pdf>

Secondly, energy prices continued being underpriced both to support financial and production activities in real sector and for social considerations.¹⁸⁷ Yet as the experience of the Soviet economy shows, after some period of time this policy comes to failure, since relatively cheap energy resources eventually lead to overconsumption, but not to their efficient use, as well as to dwindling energy reserves and aging capital, due to lack of both internal resources and foreign injections to maintain investment process. With neither production costs nor profit margin to be covered, this process finally results in permanent decrease in production

Thirdly, despite the measures of the government on significant increase of energy prices throughout the 1990s and in 2001-2003, under the inadequate exchange rate regime with highly appreciated national currency (Uzbek sum) price distortions on energy resources still remained substantial, while any increases were offset by inflationary trends.

¹⁸⁶ Alternative sources also point at low efficiency in Central Asian energy use. For example, *Diagnostic Report on Energy Resources in Central Asia* gives the following figures for 1999: Kazakhstan – 1.02 tons of oil equivalent per \$1000, Kyrgyzstan – 1.0, Tadjikistan – 0.85, Turkmenistan – 2.16, Uzbekistan – 1.21, Central Asia – 1.16, while OECD – 0.37, Germany – 0.33, Japan – 0.28, USA – 0.44.

¹⁸⁷ Partly such a strategy is explained by official authorities as necessary measures to pursue socially oriented economic reforms, to provide access for local population to relatively cheap energy resources.

Fourthly, one of the distinctions in energy development in the past decade was oil and energy independence. The republic ceased import of oil and steadily increased its gas production. It suffices to say that 17% out of 51% of total government investments into the economy during 1991-2000 were spent for the needs of fuel and energy complex.¹⁸⁸ Yet economic price of political decisions is as usual high. Energy self-sufficiency forced the country to invest heavily in the development of its energy complex, also through the multilateral foreign financing. Currently it is another burden put upon on the sector development in addition to domestic outstanding energy payments.

Thus, the core of the modern energy problems in Uzbekistan could be seen not only in the changes of economic interrelations and management system, but in a set of financial and legal instruments in government policy. They are:

- financial destabilization in the energy complex due to arrears and debts between energy consumers and suppliers;
- high technological costs and weak incentives to innovations to reduce production costs;
- inadequate price policy which caused subsequent disproportions between prices on various types of energy and oil resources, as well as between energy resources and other goods and commodities;
- tax policy which encouraged fiscal interests rather than efficient investment activities in the energy complex;
- overconsumption and high energy intensity of the economy.

In such conditions, simultaneous reforms in various dimensions are strongly required.

3.1.6. Strategy for Further Development

Urgent Tasks

*“Only in terms of oil independence, the republic can feel itself really independent”.*¹⁸⁹

The strategic energy priorities are most likely to balance between the following critical tasks:

¹⁸⁸ See „Problemy razvitiya TEK i voprosy bezopasnosti strany (Problems of Fuel and Energy Complex Development and Country’s Security Issues)“. Report in the seminar on „The Energy complex of Uzbekistan in XXI century“. Ekonomicheskii Vestnik Uzbekistana, No 4-5, 2001.

¹⁸⁹ Translated by the author from I.Karimov (1995) „Iqtisodiy islohotlarni chuqurlashtirich yolida“. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.384.

- higher production efficiency via the reduction of energy intensity of domestic industries
- adequate use of the mineral resource base
- support of domestic competitiveness
- satisfaction of domestic demand for energy in terms of steady economic growth

For this, there are the two main questions which have to be resolved first and foremost, i.e. (a) to improve financial situation and maintain its economic viability; (b) to create competitive market environment in the sector. Both of them are closely linked and dependent on a number of coordinate measures in price policies, corporatization, demonopolization, privatization, as well as on the attraction of foreign investments into the sector.

To resolve financial problems of the sector is complex and time consuming process requiring a step-by-step approach in local conditions. It is to focus mainly on the elimination of commercial deficiencies and operational inefficiencies.¹⁹⁰ One of the fundamentals of this process is to move towards appropriate pricing of energy commodities and products. Prices are critical in three dimensions: to meet all costs and allow for accumulation of surpluses for investment inside the enterprises; to adequately pay the interest and repayment on borrowing; and to provide returns on equity capital. But current situation does not allow to undertake drastic price liberalization in all energy subsectors, on their products and services, since it directly affects the two largest energy consumers: the residential sector and real sector. The first one has relatively low purchasing power, while the second one needs to face serious restructuring and privatization programs. Since price increases in the sector are unavoidable and a matter of time only, the government would need to devise and announce a specific programme of these increases which would remove uncertainties, and allow for consumers to plan for reduction in consumption, as well as raise the credibility among potential investors. In the long run, such programs would transform into integral part of energy policy making all the parties concerned familiar with the clear principles of tariff setting for both investment plans and for better transparency and predictability of domestic policy measures.

On the other hand, certain groups of population will without doubt be in need for protection to offset the harshness of regular price increases. This means additional social protection costs for the government. The policy will concentrate itself on the mobilization of its own resources

¹⁹⁰ Commercial deficiencies include non-payments, poor collection procedures, quasi-fiscal activities in the sector. Operational inefficiencies include physical losses due to old energy infrastructure and inadequate maintenance. For more details see: Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003. p.8.

or to search for the off-budgetary sources of financing these costs. Moreover, price increases may be launched with those products which affect the residential sector to a lesser extent. According to the structure of consumption, price increases would first face coal and petroleum products, while gas and electricity could be covered at the next stage.¹⁹¹

Demonopolization and corporatization are seen as the main vehicles to better understand the cost structure and profitability of the different components of the energy system, and to increase efficiency, transparency and accountability in the management of the sector. Privatization is seen as the main vehicle to mobilize resources to meet current and future capital needs – particularly those of the rapidly aging energy equipment. As the analysis shows, current structure of decision-making barely addresses the monopoly cases. In power industry, Uzbekenergo still retains monopoly status through two its subsidiaries Uzelectrosbyt (buying and selling of energy) and Uzelectroset (transmission grid). In the first case power generation and distribution companies are therefore significantly dependent on both price policies and infrastructure and thus may have little incentives in production and marketing. If the generation and distribution companies could enter into direct contractual agreements under the supervision of the third responsible authority, acting on the basis of legally separated entities, it would back their market positions under the influence of the improved internal structural and financial capabilities. The role of the Uzbekenergo will thus change from the intervention into commercial deals towards the creation of adequate transmission and infrastructure facilities.

In oil and gas industry the work has been already underway to improve the organizational structure. Yet, like in some other state institutions, commercial activities continue to be complemented by regulatory functions.¹⁹² In such case, neither Uzbekneftegaz nor its subsidiaries seem to be free in the independent implementation of their specific functions. If Uzbekneftegaz is supposed to be a regulatory body, then its structure should be based primarily on the general problems, such as a granting of licences for exploration and production activities, environmental issues, as well as dealing and the supervision over monopoly aspects in the sector, such as access to the domestic pipeline system. In turn, the main production units would be engaged more independently into production and subsequent transportation of their products on commercial and mutually beneficial terms. Finally in the

¹⁹¹ Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003. p.8.

¹⁹² It still remains unclear about a status of Uzbekneftegaz which embraces the mixture of both commercial and regulatory functions. The company is equally the licensor of new concessions for explorations and drilling, partner in any production and sharing agreements, has its own dominant position in exploration and production activities and own refineries, gas processing and gas transmission companies via respective subsidiaries, as well as an intermediary to the policy initiatives devised at the government's level.

long run, given close interrelations between the energy industries and for saving administrative costs, a single supervisory agency for all energy industries (oil, gas, coal and electricity) could be set up. In addition to the aforementioned technical issues, it is critical that the given agency would be logically provided with the economic functions too which include price and tariff policies and which is not the case nowadays. The body would be in particular engaged into setting and monitoring the prices for different categories of consumers and selecting the form of price regulation to be adopted. This would not only promote an urgent economic revival of the sector, but also reinforce the creditworthy and transparency among foreign investors whose assistance to the sector is another critical aspect.

But the aforementioned measures would require adequate legal framework too. These steps might include not only the adoption of appropriate new national laws on oil and electricity outlining the substance of structural reforms in the energy sector, but also the improvement of the existing legal base directed on the elimination of impediments to put the sector on the foot of sustainability. It also means the legal reinforcement of commercialization of the sector via pushing through contractual obligations between suppliers and consumers of energy resources. In other words, these measures should promote a commercial discipline and financial viability of the sector which in turn is crucial to strengthen competitive environment both among energy producers and consumers.

As mentioned, foreign investments into the sector are essential for a number of reasons. There is a perceived exigency to replace the hydrocarbon reserves by accelerating exploration and development at existing deposits and undertake exploration for new resources. In power industry, the situation is even more critical in view of the high level of out-of-dated generation capacities in thermal plants and transmission lines which both lead to significant losses of the energy produced.¹⁹³ It obviously requires huge financial injections. Yet the resource constraints faced by the sector are substantial, while a large amount of public financing in the energy sector in the past decade put certain limitations on further investments from central budget too. This makes foreign investment crucial both in financial terms and in terms of technologies and know-how. Yet, the interests of investors are confined to primarily exploration and development activities. For that reason, investors are less keen so far in the

¹⁹³ To some degree, the government has already started with the realization of the aforementioned measures. In 2000, the Cabinet of Ministers issued Decree “On the Programme of Reconstruction and Development of Generating Capacities in Uzbekistan till 2010” according to which system’s modernisation is due to be implemented. In 2000, EBRD and concern “Siemens” (Germany) used \$27,8 mln. credit line to begin modernizing two of ten power units at the Syr-Darya power plant. The construction of a hydroelectric power station is expected to increase the plant’s power-generating capacities from 600 MW to 3600 MW. Another project on the reconstruction of the Tashkent State Regional Power Plant is fulfilled by Mitsubishi (Japan) which earmarked about \$234 mln. for this purposes. The impact on environment is expected to be decreased by installation of modern steam-gas turbines into the energy production.

long term and huge investment projects with diversified commitments urged by the relatively young privatisation programs. Moreover, foreign investments inflow is immediately correlated with the impact of measures on the improvement of financial situation and regulatory arrangements, in addition to the creation of the adequate legal framework in the sector. Once investors see the elements of revival and profitability, they will express much more viable desire to vye for a particular field based on their competitive strength. In such terms, it will require from the government more intense preparatory activities to tackle the aforementioned problems as soon as possible, as well as express its preparedness for dialogue and talks on the multiple choices for investors. In terms of global competition for foreign investments, the policy should be able to consider different forms of privatization, including asset sales, concessions, joint ventures, and even management contracts, for businesses where investor interest is low.

Equally, however, the mobilization of additional resources from foreign sources is currently related to economic and, to some extent, to political costs too. Economic costs include both direct and indirect. Direct costs will probably arise from the necessity to make concessions and bear PR costs in order to face severe competition in persuading investors to put money into the various subsectors, which include not only exploration and production activities, but also relatively less profitable services and infrastructure facilities, as well as Uzbekneftegaz itself. In turn, indirect costs are expected to be caused by the urgency of the preparatory measures at the pre-investment stage. For example, if energy prices are gradually liberalised, the government will need to intensify its social policy to somehow mitigate the adverse effects and the consequences of these processes on certain social groups. As to political costs, they may mainly be generated by the internal nature intrinsic to foreign investments. In line with the most important driving forces of investments to seek for cost effective activities worldwide, at present they may look for the establishment of a control, very often a substantial control, over the units in new places.¹⁹⁴ For the local government it means to relax its own influence sphere resulting in a some kind of a loss of sovereignty in the new globalized business order. Nevertheless, to attract foreign investments it is an urgent task in helping the country reach more ambitious and far-reaching goals of national scope.

¹⁹⁴ Micic M. International Trade. St.Martin Press, New York, 1998, p.267.

Complementary Measures

As stressed above, Uzbekistan is still among countries with high consumption of energy per unit of GDP produced. To this respect, the reduction in energy intensity in the fuel and energy complex itself should be considered as the priority in oil and gas industry. The main task of state policy is to encourage energy saving, as well as investment activities of enterprises for modernization and technological progress. This strategy is to be a two-pronged, which means both to raise efficiency of current consumption and to rationalize it through looking for additional sources of energy. According to official estimates, the potential for saving in domestic economy is very high and will make up about 12 mln.tons of oil equivalent annually by 2010 via modern energy-saving technologies, develop hydro, solar, thermal and wind sources of energy generation.¹⁹⁵

The initial emphasis on high volumes of extracted hydrocarbons (oil and gas) in the past decade was justified by the necessity to reach macroeconomic stabilization and avoid sharp production declines and social backlash. However, at present, in terms of irrational use of non-renewable resources, this approach needs some reconsideration. It becomes vital for the republic to develop domestic economy on the basis of efficient production and consumption of traditional resources (oil and gas), as well as to increase the share of other energy sources, including non-traditional (solar energy, for instance).

In turn, to enhance investments into the resource-saving technologies, it is necessary to develop complex measures on structural changes in the economy which would assume restructuring and the sanitation of inefficient large and medium-size industrial enterprises in general and in the energy sector in particular. As a sound atmosphere in the energy sector with efficient full-accountability and profitable enterprises will form, one would be possible to expect firms and companies to be more efficient and innovative. Enterprises with a more financial discipline will invest more prudently and minimize productive factor use, including waste of energy resources.

It is also clear that investments into the energy-saving technologies should be considered as one of the priorities in the overall strategy which results both in direct and indirect advantages. These positive consequences could be characterized through the reduction of energy intensity, as well as direct costs of production; higher quality of products and overall competitiveness, both on domestic and foreign markets; less negative environmental effects.

¹⁹⁵ Mavlany J. Uzbekistan: New Energy Saving Programm. BISNIS service, 2001, <http://www.bisnis.doc.gov/bisnis/bisdoc/010730UZENERGY.htm>

Among the economic measures of energy saving, the following steps could be useful: reasonable privileges¹⁹⁶ to economic units using energy saving technologies; accelerated pace of amortization; flexible taxation; financial sanctions for the infringement of contractual obligations of consumers before the energy suppliers.

Equally the middle- and long-run prognosis of energy consumption in Uzbekistan is a vital and necessary element of energy development. These forecasts are based on the necessity of diversification for production and consumption of domestic energy resources. That implies that a certain share of traditional sources of energy (oil and gas) could be replaced with renewable and more endowed resources (like coal,¹⁹⁷ solar energy). This strategy is important not only from economic point of view, but also from political one to ensure national security.

At the same time the developments in the energy sector should go with the worldwide trends too. One of them is liberalization which related to deregulation and competition, development of regional and inter-state energy markets. As a rule, liberalization leads to more efficiency in the energy sector, strengthening mutual influence and inter-dependence between energy systems of states and regions of the world. Therefore, energy cooperation within Central Asia is of crucial importance for all, the states and the public of the whole region.

Another trend is decentralization which will be related to the decrease of construction of large central heating, electro– and energy supply capacities on large territories. The focus should be made on the capacities of smaller scale, with primarily efficient use of gas turbines, stream installations, other renewable sources in production of energy.

In addition to the comprehensive measures on the macrolevel, a number of steps has to be undertaken on the microlevel as well. According to some estimates, enterprises of the republic possess approximately 15-20% energy-saving potential.¹⁹⁸ The main idea of the mentioned is that energy-saving should become a basis for the overall strategy of development of the fuel and energy complex in Uzbekistan for years to come.

The role of energy audit, in this respect, is of no less significance. It will be based on gathering and analysis of data on purchasing and using most efficient energy resources. These data should reveal energy losses of enterprises during production process, therefore,

¹⁹⁶ The privileges should have their limits, as their abuse may result in inefficiency in the entire economic system (prices distortions, redistribution of income, corruption).

¹⁹⁷ On the condition of the adequate economic (competitiveness) and environmental balance in terms of possible greenhouse effects, though the question may remain open at least in the short run.

¹⁹⁸ According to those estimates, energy saving of 1% across the republic makes possible to decrease energy generation by 500 mln.kWh, and therefore, to save 100 mln.toe. See: S.Uspenskaya „Energeticheskiy audit i energosberejneniye“. Ekonomicheskiy Vestnik Uzbekistana. No 9, 2001

subsequent development of measures to eliminate such losses, including investments into resource-saving technologies and equipment. Besides, improvement of management and planning on energy saving, establishment of special norms and energy standards, as well as thorough statistical accounts are expected to be the most desired steps on energy management. Thus, further development strategy for the energy sector will depend on decisive steps on macro- and microlevel. This approach requires the entire set of organizational, economic, technological, ecological, as well as political steps. If on macrolevel, the principles should take into account globalisation, liberalisation, diversification, decentralisation and modernisation trends, on the microlevel the more attention should be paid to the efficient use of energy resources. Stability and security in the energy supplies, as well as diversification of energy sources is not only economic, but also a big political task which ensures energy security of the country. When energy resources are equally regarded as a factor of sustainable development and integral part of international diplomacy, it requires to pursue prudent energy policy for domestic and regional stability.

3.2. Perspectives for Resource-based Industrialization

3.2.1. Mineral Base

*“If we take into account that the republic is forced to rely primarily on its own resources, it becomes clear why one needs first to develop the vital basic industries, such as the oil and gas complex, the energy sector, gold mining and non-ferrous metallurgy, communications and infrastructure...”*¹⁹⁹

In transition economies, reforms include substantial trade-offs between a variety of economic and social objectives, let alone political constraints and imperatives. To provide high and sustainable economic growth, and to raise country's productive capacities, is a pre-requisite of social prosperity and political stability. The main task is how to provide desired efficiency of socio-economic and political measures in terms of consumption and capital formation, both in level and time; the composition of output by sector; the profit distribution; adequate size of investments, etc., i.e. all which could maintain the process of transition from one type of economic development to another which is qualitatively different and complex. On the other hand, the process of industrialization will touch upon labor-intensive industries too, such as agriculture for instance, which could be inadequately perceived in societies traditionally used

¹⁹⁹ Translated by the author from I.Karimov (1995) „Iqtisodiy islohotlarni chuqurlashtirich yolida“. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.384.

labor force, but suddenly shifted to the mechanization of production. It makes additional pressure on social aspects reflected in the more proportional distribution of income between the rich and poor people, between the rural and urban areas, the issues of migration from the rural areas to the cities, as well as rising unemployment. The question is how to make this process steady and at least social costs.

Industrial policy became one of the important elements of domestic policy in Uzbekistan after independence. It was reflected in huge government investments into capital-intensive spheres, like the mining and energy sectors. Rich mineral base allowed to benefit from high rents at relatively short period of time, so that to keep state budget balance stable. Yet for Uzbekistan it appears to go a long tortuous way to complete this process. The case is also exacerbated by the existence of the old industries which were mainly developed in the Soviet era. Most of them represent basically the initial stages of extraction and manufacturing of raw materials, with small value added. Therefore, they contribute comparatively little to the whole national income. After ten years of independence, agriculture still gives twice as much in total GDP than industry. On the contrary, the share of industry decreased in comparison with 25% in the early 1990s to 14-15% during the last five-year period.²⁰⁰

*“We did not choose an easy way. At the early stages, we had to limit our domestic consumer market... Our domestic and borrowed funds were primarily earmarked for investments, for the import of new machine and technologies. We were increasing investments, rather than consumption... Today we have already got certain results... Difficult years of the hard work to lay the national-building and economic foundation of the country in order to provide national interests of the republic and its people, have already gone by”.*²⁰¹

A particular emphasis was put on an import substitution strategy of structural transformation and modernisation of the economy through a number of large industrial projects in the past. Political implications of this process could be probably seen in that the state intended to the gradual elimination of the former, so called “Soviet structure” of the economy with agrarian and resource orientation which would remind somehow “Soviet Uzbekistan”.

Equally, however, industrialization is a long-lasting and costly process which will require to take into account the comparative advantages of the country in terms of capital invested. The latter implies a group of human, natural and social capital in any particular country. Resource

²⁰⁰ IMF, State Committee on Statistics of the Republic of Uzbekistan

²⁰¹ Translated by the author from I.Karimov (1997) Uzbekiston XXI asr bosagasida: havfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.571.

endowment is normally considered as an initial positive pre-requisite for industrialization comparing to the countries with a poor mineral resource base. But it is not the only important factor. For example, small economies with limited domestic market and poor natural resources, relatively unfavorable geographical location (far distance from the main world markets) and so forth, were facing difficulties with industrialization.²⁰² On the contrary, the most striking thing is that the countries poorly endowed with mineral resources, turned out to be much more efficient with the use of the latter that subsequently had provided faster rates of economic development, while “rich countries” had faced lagged economic growth and huge dependency on primary exports (Persian Gulf states during the oil shocks in 1973-74 and 1979, Venezuela, Nigeria, Cameroon). If industrialized countries did well with structural changes in consumption and less dependency on energy import, then, the biggest challenge of oil producing countries was high dependency on export of one resource – oil²⁰³ which caused stagnation and socio-economic problems in their economies after sharp decrease in oil prices in 1983-1986. That is why, the question whether resources are a curse or a blessing for a country still remains a source of disagreements between the economists worldwide.

Mineral and natural resources of Uzbekistan would be in principle sufficient to secure its economic development in terms of an assumed economic autarky. From the outset, they are a topic of the official discourse on the highest level:

*“Uzbekistan possesses sufficient potential which would allow it to overcome its heavy legacy, overcome the crisis, achieve economic independence and then, join the most leading countries in the world. The rich natural resources endowment makes possible to change the entire domestic structure of the economy, and to develop those industries that provide comparative advantages of the country on the world markets. In terms of independence, land and resources in a line with economic, scientific and technological opportunities and intellectual potential, will serve as a basis for social progress and as a guarantee of people’s welfare”.*²⁰⁴

What might be political implications of these quotation? First and foremost, natural resources gave the government access to funds, to finance structural changes in the economy. Secondly, since commodities, such as gold and copper, could be easily sold on the world markets at any time, such a strategy provided the republic the possibility to find out its primary niche and

²⁰² By „small economy“ in the given context, must be seen a country with relatively small economic potential measured on GDP, population and territory. For more details, see: R.M.Auty (1990) “Resource-based Industrialization: Sowing Oil in Eight Developing Countries”. Clarendon Press, Oxford

²⁰³ Atif.R.Kubuasi (1984) „Oil, Industrialization and Development in the Arab Gulf States”. Sydney-New Hampshire

²⁰⁴ Translated by the author from I.Karimov (1993) Uzbekiston – bozor munosabatlariga o‘tishning oziga xos yuli. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.95.

what is more important, to set up much-needed contacts with foreign investors. Thirdly, the mineral resources were considered as a foundation to a stable development of domestic industries in terms of the socio-political and economic turmoil across the former Soviet space. And finally, it was probably a political sign to show that Uzbekistan had a sufficient potential, including mineral, to keep up its newly acquired sovereign development.

Table 3.3. Assessment of Mineral and Energy Potential of the Republic of Uzbekistan

Types of minerals	Value of mineral reserves		Assessment of mineral potential	
	Bln.USD	% from total value	Bln.USD	% from total value
Total	1025	100	3540	100
incl.oil, gas, condensate	285	28,8	1164	32,9
Coal	105	10,2	110	3,1
Non-ferrous, rare, radioactive and black metals	154	15,2	713	20,2
Ceramic and glass materials	66	6,4	89	2,5
Refractory and other mining materials	155	15,1	194	5,5
Raw materials for production of fertilizers	42	4,1	95	2,6
Raw materials for chemical industry	62	6,0	468	13,2
Construction materials	146	14,2	707	20,0

Source: Ekonomicheskiy Vestnik Uzbekistana, No1/2, 2001, p.44.

Uzbekistan today is the 11th in the world by copper reserves, 7-8th – by uranium, as well as the third largest producer of natural gas in the CIS (after Russia and Turkmenistan). Following neighboring Turkmenistan and Kazakhstan, the resources in Uzbekistan are huge enough to be influential in both domestic and regional terms (Annex 3.3).

There are also the reserves of various non-ferrous metals like copper, lead, mercury, tungsten and others. It is interesting that while extracting copper, another 15 metals may be extracted similarly. They are gold, silver, molybdenum and some others. Endowment with copper and other by-metals are sufficient for 40-50 years, while lead and mercury – for 100 years. The main mines of these metals are located in the Tashkent region (Almalyk) and the Almalyk mining plant (with its mines Kalmakir and Dalneye) is not only the largest producer of copper and molybdenum, but also one of the largest plants in the republic at all.

Lead and mercury are produced mainly in the Djizakh region (Uchquloch) and Surkhandarya (Hondaza). The peculiarity of extraction there is their high productivity, because one may obtain 99,99% of metals out of rock extracted. In addition, the rare metals like lithium, tellur,

selenium are necessary materials for the production of semi-conductors, solar batteries, thermogenerators, steel, some types of glass.

The reserves and the use of phosphorites have another priority for Uzbekistan today for a number of reasons. Firstly, the reserves are tremendous (from 100 mln.tonnes and even boundless depending on the mines: Qoraqat, Northern Djetitov – both Central Kyzylkum). Secondly, they can be used to have phosphor fertilizers. The latter could be primarily used domestically in agriculture. Thirdly, it can be widely exported.

At the meantime Uzbekistan has huge reserves of kalium used in the production of fertilizers for domestic agriculture. Their mines are located in Tubakat (Kashkadarya) and Surkhandarya. They are expected to be available within the next 100 years. There are sufficient materials to produce calcium and caustic soda.

3.2.2. What May It Bring ?

Yet the question is whether the republic could benefit from its natural wealth and, if yes, to what extent. There have been already a number of debates on this issue. In particular, some researches conclude that it was cotton, energy and mining industries which had prevented abrupt decline of GDP at the early stages of post-Soviet development in comparison with other transition economies (see J.Zettlemeier, 1999, R.M.Auty, 2000). Others (B.Islamov, 2001) see this success not in natural resources, but in the policy measures which maintained stable investments into the real sector.

Here there is a dilemma which many governments face. On the other hand, the government is the main owner and distributor of mineral resources, partly because they serve as a stable source of revenues. The government has a direct control over prices on energy resources that may mainly consist of excises levied on producers of energy resources. In such a way, these efforts are directed on the repression of inflation and provide an access to cheap energy resources for producers and residential consumers. On the other hand, however, such a policy runs a risk of both misallocation of the resources among economic sectors, and their irrational consumption. As mentioned above, the Soviet system was inclined to overconsumption of its energy resources. Specifically, in such a system with misleading incentives for consumer and producers of energy resources, government seeks to settle domestic resources bottle-necks with supply-side rather than demand side remedies.

The role of fuel and energy complex has increased significantly during the years of Independence, from 6,5% in 1991 till 21% in 2001. The energy sphere played a key role in the realization of structural changes and pronounced investment projects. It is reasonable to

expect that in the middle-run the energy complex will keep its dominant influence on real sector development.

It needs to be emphasized that in comparison with other countries, such as Russia, Turkmenistan, or Kazakhstan, for example, Uzbekistan is not heavily dependent on both export and import of energy resources, since most of the domestically produced resources are to meet local demand.²⁰⁵ Only 10% of the most tradable resource produced, natural gas, was exported in 1999-2001, while comparatively insignificant volumes of electricity were traded. At the same time the latest steps undertaken by the government may witness about the country's intentions to expand its energy exports both in size and geography. In particular, Uzbekistan's gas export potential until recently was less than 7.8 bln.m³ a year, or 15% - 16% of production. There are plans to triple its export potential from 7.3 bln.m³ in 2002 to 20 bln.m³ by 2020. It may come from higher gas sales both across the region, i.e. to Kazakhstan (1.45 bln.m³), Tajikistan (700 mln.m³) and Kyrgyzstan (1.2 bln.m³), as well as in the CIS and even farther. For instance, the country is studying the possibility of exporting natural gas to Afghanistan, China, and Eastern Europe. Exports are going to be increased by modernizing and expanding production capacity and adding new gas fields in the Bukhara-Khiva and Ustyurt regions.²⁰⁶

Equally, however, although the role of the energy sector as a necessary pre-requisite for the future development is not compromised, long-run success is going to be also dependent on how these export earnings from physical assets will be absorbed and spent within the economy bringing social effects. In other words, sustainability and progress has much to do with the policy actions in a much broader context, embracing non-energy areas too.

The world experience showed that in countries with rich energy resource base other manufacturing industries actually remained underdeveloped.²⁰⁷ The reasons for mounting inefficiencies could be found in a number of factors, such as waste of resources, poor incentives to energy saving, inadequate legal and institutional environment, etc. The preoccupation of governments with resource-based industrialization (RBI) and their snail-like progress in the creation of competitive non-resource based manufacturing provided an

²⁰⁵ In 2000, the share of energy products in total export was about 10% in comparison with Russia and Kazakhstan where total energy and mineral export may make up to three fourth of export earnings.

²⁰⁶ Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>. The energy exports is analyzed more closely in the Chapter IV.

²⁰⁷ Such a trend is referred to as "Dutch disease" reflecting the phenomenon of deindustrialisation or the contraction of the traditional manufacturing (exporting) sector due to the rapid expansion of the extractive sector of the economy. This took place in Holland when natural gas extraction grew rapidly which adversely affected other industries. For theoretical explanation of this phenomenon see in Micic M. International Trade. St.Martin Press, New York, 1998, pp.154-157.

inadequate industrial base from which to sustain economic growth and export diversification. These countries embarked on the way of industrialization during the period of oil shocks which allowed them to accumulate substantial volumes of foreign exchange at the expense of the oil consumer in oil-importing countries. Their experience shows that those (Malaysia, Indonesia, Cameroon) who prudently pushed the development of both oil based and non-oil based industries (agriculture) could achieve more sustainable economic growth after the decline of energy prices in the mid-1980s. Compared to them, others (Saudi Arabia, Nigeria, or Venezuela) to a different extent failed in ensuring stable manufacturing development.²⁰⁸

Some researches discovered that main factors of success in RBI are secured by resource endowment, physical capital, institutional infrastructure, and the government policy.²⁰⁹ For such countries, the average distribution of capital consists of 60% from natural capital (resources endowment), 20% - human capital, 20% - social infrastructure. A study of investment potential in developing countries demonstrated that all resource-based industries, except wood products, have capital-labor ratios three to ten times the average for all industries combined, and labor coefficients 33% to 80% below the average. This suggests that such industries are highly capital-intensive and do not need much labor force.²¹⁰

In past years Uzbekistan's official policy was dominated by the development of a number of huge, capital-intensive projects in fuel and energy complex. In terms of shortage of government funds, the state redistributed national income among the main sectors of economy, primarily from labor-intensive agriculture to capital-intensive industry. However, given the current endowment with more than sufficient labor force, the trend which most probably will retain in the foreseeable future, it is also important to enhance labor-intensive projects related to palpable social and economic effects. It necessitates a gradual move from capital-intensive energy-related sectors to the development of manufacturing industries. The latter include first of all light and food industry which in turn are closely related to the agricultural sector where the main labor force is concentrated. It is expected that the share of these industries will increase in the middle-run. According to estimates, further on these spheres could take almost a half of the total industrial structure. Correspondingly, the share of energy complex will tend to decrease by two times compared to 2001, and is supposed to reach 10%.

²⁰⁸ R.M.Auty (1990) "Resource-based Industrialization: Sowing Oil in Eight Developing Countries". Clarendon Press, Oxford. p.215.

²⁰⁹ R.M.Auty „The IMF Model and Resource-Abundant Transition Economies: Kazakhstan and Uzbekistan“. Working Paper 169, November 1999.

²¹⁰ Atif.R.Kubuasi (1984) „Oil, Industrialization and Development in the Arab Gulf States. Sydney-New Hampshire

Such a shift in priorities from capital-intensive to labor-intensive industries will be in line with the tasks to secure the efficient use of domestic resources. This comparative advantage of Uzbekistan would allow the encouragement and support of structural reforms in the agricultural sector, as well as to keep up necessary incentives for the agro-related industries. The stable development of labor-intensive industries could cushion the potential difficulties of transition period, stimulate more employment, raise income and its more balanced distribution among economic sectors. As a whole, this economic basis would strengthen the pillars of social stability in society. In these conditions, it becomes important to have a closer look at the possibilities and constraints of a progress through a prism of specific development models.

3.3. Possible Scenarios of Development

Model 1 suggests that the mining and energy sectors would remain top priority on the domestic development agenda due to a number of reasons. Firstly, Uzbekistan is well endowed with mineral and energy resources for such development. Secondly, these sectors are critical in earning foreign exchange which could be subsequently used by the state in pushing ahead various import substitution industrial projects, as well as undertaking social programmes. Thirdly, the sectors are essential in terms of national security, since the republic itself is a large consumer of these resources which would be necessary to ensure economic growth. The main feature of this model is therefore based on the retention of a strong government control over the aforementioned sectors through a number of instruments (fiscal, monetary, trade, investment, legislation). Moreover, since both mining and energy are capital intensive, the state policy is going to remain the main intermediary to negotiate all investment projects between foreign investors and domestic beneficiaries. Thus, political and economic tasks of the government are expected to follow a self-sufficiency pattern in key inputs, which will have an impact on the structure of export and GDP, and finally strengthen country's dependency on a couple of staples in the long-run.

Model 2 would foresee the targeted development of the agricultural sector and entrepreneurship, basically small and medium-size business (SMB). Unlike the former scenario which requires huge financial injections, the market reforms are going to start with the industries of lower capital intensity, such as agriculture, trade, and services. The basic principles of this model are two-pronged: to restrict state interference with domestic processes on the one hand, and to enhance the accumulation of private capital for future industrialisation in a larger scale, on the other hand. The first principle is mainly reflected in the simplification

of tax legislation and reduction of tax burden in domestic economy; liberalisation of foreign economic activity; the enhancement of competitive environment; the measures on export expansion, etc. If these are pursued properly, it is expected to reinforce the implementation of the second principle.

The main advantages of the given model are in that would require less investments, but could be realized within a relatively short timespan, since private sector is expected to react rapidly to the reforms launched by the government. On the other hand, the legalization of a significant part of the shadow economy would add to the sustainability of the mobilisation of investment resources and to a confidence building process between private sector and state agencies. As the next step, the expansion of manufacturing industries and large-scale industrialisation processes are expected to be intensified basically due to investments made by private sector in order to sustain the strengthened competition both on domestic and world markets.

Model 3 supposes that like in the past, state policy would continue to back up only a few largest domestic industrial companies which are going to have a privileged access to market resources. Thus the interrelations between state and these companies are very similar to those in large TNC, which take place between general office and different company's units. Decisions are made according to a hierarchy, transactions between the government (general office) and selected industries (subunits) are internalised (or "quasi"-internalised) through an organisational chain from government via financial intermediary to a selected branches or firms, and the activities of the "subunits" would be monitored and coordinated by bureaucrats (salaried government employees) which otherwise would be done indirectly through a price mechanism. The state support in the given case is mainly provided with the purpose of improving the structure and efficiency of national export, which, as a rule, would consist of the products of these companies. At the same time, a great deal of small firms will also benefit by delivering various spare parts, raw products, etc. for the head companies. If these efforts succeed, one may expect long-term benefits in terms of improved exports structure, better competitiveness, sustainable balance of payments and the possibility to put through with the desired higher level of industrialisation.

3.4. Between Constraints and Opportunities

None of the aforementioned models, however, could dominate national development due to a number of the objective constraints. Although being capital-intensive, the first model of a commodity orientation is a more easily negotiable area for the inflow of foreign investors, due

to high returns per capital invested within a short period. In addition, the liquid staples could be easily sold on the world markets at any time. Yet equally, this approach is inconsistent and short-sighted in terms of the rapid exhaustion of domestic opportunities after it has been kickstarted. The question is also quite relevant with regard to the efficiency in using the natural resource base which most probably may simply become a second-background issue in this case. Moreover, the impact of exogenous factors, such as the volatility of prices in the world commodities markets, high costs of foreign borrowings in couple with the running-out capacities of the mining and energy sectors, is huge. Consequently, domestic policy becomes fully related to the influence of external factors to determine the fate and consequences of domestic reforms and national welfare.

Since Uzbekistan is a country with an explicit labor excess, the development of labor-intensive industries would have good prospects foreseen by Model 2. The majority of population has already private agricultural plots and historically and traditionally is linked to agriculture as the main source of their income. Moreover, their agricultural output may be demanded not only on domestic market, but also beyond national borders, both in Central Asia and in the CIS. The established network of domestic light industry also creates prerequisites for the intensification of inter-sector supply schemes from which both sides could benefit. This could make local population as the primary beneficiary from growing income and job opportunities. Then private investments into manufacturing would provide some diversification of export structure with real steps towards the output of more finished goods contributing to the evolutionary industrialisation of the country. Another advantage is in that the republic may avoid substantial external borrowings reducing the risks of drowning in unsustainable foreign debts problems. Yet the most important assumption is that the aforementioned processes may occur provided that appropriate policy measures and environment would be set up. The latter will obviously a time-consuming process with the necessity of a complex approach to the solution of the contemporary problems in the republic.

The most time-consuming and costly developments are expected to take place within the Model of Industrial Development (Model 3). Although the Korean experience could serve as a pertinent case,²¹¹ Uzbekistan's position, however, is challenged by some domestic

²¹¹ This idea was especially popular in Uzbekistan in the mid-1990s, when the South Korea's experience was seen as a successful pattern to pursue domestic industrialisation. The case of Korea was referred as to reinforce a central role of state in pursuing the reforms. However, South Korea's success in this particular case was mostly ensured by drastic measures on the structural reforms in the real sector through massive privatization of large-scale enterprises. In other words, the fact that these enterprises had become private and thus could negotiate on an independent footing the strategy of target support by the Korean government. And the central role of the Korean government was in skillful coordinating of the activities of the main state institutions, and appropriate

constraints. First and foremost, since domestic resources are limited, this scenario's viability should be considered in relation to the external sources of sustainable funding. There are two possible ways in this regard: either to borrow on the world capital markets on commercial terms, or promote sustainable foreign capital inflows, in particular FDI, in priority areas of the local economy. As the first way is very costly and exerts a serious pressure, both economic and political, on modern and future generations, the second alternative if succeeded is much more preferable. But the dilemma for the state is in that on the one hand, the policy intends to improve ownership and management in large-scale industrial enterprises through incorporation and privatisation, but understandably will retain its majority stake in equity capital for strategic and national security reasons. On the other hand, the state will need foreign capital to support its privatisation process and subsequently contribute to the industrialisation process too. Yet for foreign capital, investments into exploration and development of mineral base is most probably a more attractive deal than in those units whose profits could be a matter of much longer run. Even when decisions in favor of the non-mining and non-energy enterprises have been made, the majority stake in overtaking of large scale local enterprises may become a critical issue for foreign capital.

This will thus require from the government to undertake some crucial measures on the elimination of administrative barriers, the simplification of organizational procedures and gain the sufficient creditworthy in order FDI to take more active part in the domestic structural reforms, including large-scale privatization and industrialisation initiatives in years to come. Transparency, sustainability and irreversibility of the government actions towards better business environment through a set of adequate foreign exchange policy, foreign trade reforms, simplification of customs procedures and creation of favorable investment climate are expected to be essential in this model. In other words, the state has to balance between the intensification of multi-edged reforms on privatisation, modernisation, improvement in financial situation in industries, and the enhancement of foreign capital to mitigate limited financial opportunities for the implementation of such measures.

It is worth noting that the aforementioned models are different in that they concern their specific elements, such as the role of the government, private sector, both domestic and

adjusting a set of macroeconomic tools, such tax, budget, monetary, investment and foreign economic policies for the common goal. This common goal was the creation of effective incentives for modernization in different industries, promotion of their products in external markets. At the same time, one developed financial mediation, financial and industrial groups, which served as the main intermediates for capital flows from the state to private sector playing the role of classical price mechanism in a market economy. The point of some authors about the Korean economic success also emphasizes strong land reform and upgrading of knowledge which had crucial role in complementing subsequently general government policies. See more: Chung H.Lee The Economic Transformation of South Korea: Lessons for the Transition Economies, OECD, 1995.

foreign, social impact, investment priorities, policy tools, etc. But it does not necessarily mean that they may not overlap or even follow each other. On the contrary, the models or some elements may be intertwined and reflect a particular stage of the development. For example, an emphasis on the export-oriented industrial development (Model 3) may take place simultaneously with the improvement of conditions for agricultural and entrepreneurship development (Model 2) which would lead to the general improvement of business climate. The question only whether the resources, both domestic and foreign, may be available on the sustainable basis. Besides, much will depend on how well the long-run benefits in the most progressive Model 3 could be perceived by the society comparing to a more direct impact from the implementation of Model 2.

3.5. Summary

During the Soviet era huge mineral resources were considered as a sufficient argument to develop in Uzbekistan some mining and processing industries. All the resources were underpriced allowing an access to high rents of relatively cheap local mineral resources. After the independence in 1990s, the government relied on natural base not only as a tools to undertake structural reforms to overcome one-sided resource specialization. The government considered its resource potential as a guarantee for sustainable economic growth in the future which could bring social welfare, national prosperity and political stability. Ultimately resources were also believed to be both political and economic tool in reinforcing just acquired national independence and exerting, on its basis, some efforts for sustainable cooperation with similar states in the region.

In sovereign Uzbekistan energy policy began to play an important role in trying to balance between capital-intensive industrialization policy and domestic stabilization. The well-known and widespread distortions of prices in an input-output scheme in the former Soviet system inhibited a sound and reasonable distribution of resources among the economic sectors. Therefore, national energy policy was twofold by favoring import-substitution strategy. On the one hand, it sought to secure stable energy supplies for domestic demand in industry, but also implementing socially-oriented projects through wider access to energy for population. On the other hand, strategic task, especially at the outset of independence was reflected in attempts to minimize a potential of spreading socio-political and economic destabilisation from the other republics. Both these tasks were seen as necessary conditions to reinforce political independence of the country.

At the same time, the republic had to pay high price to achieve these goals. The pressure on the country in general and its energy sector in particular could come from not only the changed economic interrelations, necessity of reforms in the management system, accumulated foreign debts as a result of the implementation of large-scale and costly import-substitution energy projects, etc. The issue may partly concern a set of financial and legal instruments in government policy itself too, which specifically are:

- financial destabilisation in the energy complex;
- high technological costs and weak incentives to innovations;
- disproportions between prices on various types of energy and oil resources, as well as between energy resources and other goods and commodities;
- fiscal orientation of tax policy;
- overconsumption of energy resources leading to high energy and material intensity in GDP.

In this regard, the national energy strategy should foresee stability and security in supplies of energy in the future. Prices should promote efficiency in production and energy-saving. From the social point of view, it is crucial to take into account minimum privileges provided by state to the needs of those social groups who will really need some government support. Politically, the national energy strategy should stem from the national interests of Uzbekistan and contribute to its energy security. For these purposes, a combination of organizational, economic, political, technological, ecological steps will be required, including:

- ❖ forecast and formation of energy demand taking into account energy-saving activities;
- ❖ development of the small-scale energy sector, i.e. construction of thermal ES of small capacities, similarly improving generating capacities;
- ❖ prudent regional energy policy between regions having an excess in energy and those with energy-shortages;
- ❖ reasonable technological and ecological policy;
- ❖ optimization of price and fiscal and investment policies;
- ❖ gradual demonopolisation and incorporation of the energy sector;
- ❖ the enhancement of foreign investments on the basis of bi- and multilateral energy cooperation on the interstate, regional, and interregional levels.

The world experience showed that in countries with rich energy resource base other manufacturing industries actually remained underdeveloped. Although the role of the energy sector as a necessary pre-requisite for the future development is not compromised, long-run success is going to be also dependent on how these export earnings from physical assets will be absorbed and spent within the economy bringing social effects. In other words, sustainability and progress has much to do with the policy actions in a much broader context, embracing non-energy areas too. The latter include first of all light and food industry which in turn are closely related to the agricultural sector where the main labor force is concentrated. Such a shift in priorities from capital-intensive to labor-intensive industries will be in line with the tasks to secure the efficient use of domestic resources. This comparative advantage of Uzbekistan would allow the encouragement and support of structural reforms in the agricultural sector, as well as to keep up necessary incentives for agro-related industries. The stable development of labor-intensive industries could cushion the potential difficulties of transition period, stimulate more employment, raise income and its more balanced distribution among economic sectors. As a whole, such an economic basis would strengthen the pillars of social stability in society.

Generally speaking, Uzbekistan's sustainable development could be analysed within various development models which are not new in international practice. Among others, the following could stem from: 1) an emphasis on the development of the mining and energy sectors through the expansion of liquid commodities exports; 2) the targeted development of the agricultural sector and entrepreneurship; 3) policy-led efforts on the protection and support of the large-scale corporate interests, both in domestic and foreign markets. The realization of each of the models will depend on local demographic, technological, financial, ecological and foreign constraints, as well as at the particular stage of the reforms in each single area, both in the domestic and external sector. Not at least, this is going to be connected to regional developments too, including regional trade in energy and the related products, improvements in infrastructure, structural reforms, common investment strategy, and export expansion, with particular geopolitical and geoeconomic implications. But this is to anticipate the following chapter which will examine all the aforementioned issues.

CHAPTER 4. THE ENERGY ISSUE IN THE CENTRAL ASIAN REGION

4.1. Energy Potential of the Region

*“A number of various political, economic, military, transport and ecological problems are piled up in the Central Asian region. If we take this into consideration, the only appropriate principle to ensure consequent and sustainable development of the whole region today lies in preserving and supporting domestic and foreign balance. Only in case of keeping the geo-strategic balance and stability in the region one may resolve these challenges. In its turn, it may serve as a significant contribution to the solution of common security issues”.*²¹²

The developments in post Soviet Central Asia have already ranked among the hottest and controversial topics in the discussions on international relations for the last time, though only as much as one and a half decade ago the countries from the region were known little to the world community.

The food for such debates may partly come from the speculations over the amounts of natural reserves both actual²¹³, and those which may be explored in the future. In Western literature, Central Asia is included in the so called “Caspian basin”, with Caucasus. But only two countries of Central Asia (Turkmenistan and Kazakhstan) have direct access to the Caspian sea. The other republics (Uzbekistan, Kyrgyzstan, and Tadjikistan) have little to do, neither geographically nor legally, with its huge resources. However, due to socio-political and economic developments in the last years the Central Asian region has come under the spotlight of international attention. As the words of a British geographer H.Mackinder come on the mind who particularly noted: “The might of this wide region stems from the vast amounts of wheat, cotton, energy resources, metals, and population which enable the region to develop, though being left much far away from the oceanic trade”.²¹⁴

Central Asia possesses a significant and diversified energy base, although the resources are unevenly spread throughout the region.²¹⁵ Apart from vast volumes of proven recoverable

²¹² Translated by the author from Karimov I. (1997) O'zbekiston XXI asr bo'saga'asida: xavfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Collection of works “Uzbekiston – buyuk kelajak sari”, Tashkent, 1998, p.422.

²¹³ In view of wide range of estimates, it is hard to show genuine natural and energy potential of Central Asian countries. All figures should be considered as approximate and subject to change.

²¹⁴ Mackinder H. The Geographical Pivot of History, The Geographical Magazine 23/4 (1904). Translated by the author from the reference in Alimov R.M., Arifkhanov Sh.R., Rizaev S.R., Tolipov F.F. (2002) Tsentralnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost. (Central Asia: Geoeconomics, Geopolitics, Security), Tashkent. p.87

²¹⁵ The figures, as to resource potential of the region are actually confusing due to a variety of estimates. We try to operate with some modest figures, though they still remain impressive (Annex 3). For example, according to US Energy Information Administration, proven oil reserves in Kazakhstan may range between 9 and 17 bln.barrels with future potential of 92 bln.barrels; gas 65 and 88,3 trln.cubic feet, respectively. For Turkmenistan: up to current 1,7 bln.barrels of oil, with potential

hydrocarbon reserves, the region has huge hydro-power capacity, large deposits of uranium, and favourable conditions for the development of non-conventional renewable energy (Annex 4.1a).

The ratio between the natural resource potential and the volume of mined/generated energy indicates the time of availability for a particular resource in a country or the whole region (self-sufficiency). In 1998, this indicator for proven recoverable coal reserves stood at more than 600 years; for oil, 65 years, and for natural gas, nearly 75 years.²¹⁶ But these figures may be seen as conditional and subject to change regularly, especially after a number of oil and gas projects in the Caspian area, such as Eastern Kashagan, Karachaganak of Kazakhstan, the Ustyurt region in Uzbekistan, Dauletabad in Turkmenistan are discovered and launched with the help of foreign investments.

One needs to be careful in treating estimates of this kind, as they could embrace some degree of both objectivism and subjectivism. On the one hand, it is obvious that with time gone by, such figures are destined to reconsideration, since new fields are discovered as the volume and geography of research and exploration works tend to expand in the region. Yet, the level of knowledge about the true resource base leaves much to be desired, due to lack of funds for conducting research projects.

On the other hand, there could be some differences of a methodological nature. However, the aforementioned two explanations may not be sufficient to make the whole picture clear. Speaking broadly, it could be supposed that these estimates would also be a result of long-run geopolitical and strategic interests, both domestic and external, as an opportunity to secure political support of far-going economic concerns. If domestically, it is the government itself which is interested in showing bigger resources potential to encourage foreign investments; then, from the “outside” these heightened interests are expressed by influential multinational corporations majoring in extraction and development of profitable energy resource base across the globe. Moreover, in recent years such corporative interests are more often merged with the national political priorities that encourages us to consider them in a close interaction. From this point of view, Central Asia, a specific region located on the cross-roads of regional

of another 38 bln.barrels, and gas 71 and 159 trln.cubic feet, respectively; Uzbekistan’s current oil 0,6 bln.barrels with potential of 2 bln., and gas of 66 trln.cubic feet with potential of 35 trln.cubic feet, respectively. The French estimates say about 70-250 bln.barrels of oil reserves; the British showed more restrained 28 bln.barrels of oil and 243 trln.cubic feet of gas; Russian experts believe that there are 7 to 8 bln.tonnes of oil and 5 trln.m³ of gas in the whole Caspian region. Sources: Energy Information Administration <http://www.eia.doe.gov/emeu/cabs/caspstats.html>. See also: Testimony by John J.Maresca, Vice President of UNOCAL Corporation (USA) to House Committee on Asia and the Pasific. 12 February 1998, Washington D.C. See also: Babak V. Kazakh Oil: Economic Booster or Dead Weight? Central Asia and Caucasus, 2001; Patridge D. Central Asia: How Vast are the Riches in the Caspian?. RFE/RL, London, 16 July 1998

²¹⁶ Diagnostic Report on Energy Resources in Central Asia, <http://centrasia.cintech.ru/energy-eng.pdf>

and international interests on the entire Euro-Asian continent, could be considered as a target of international expansion on different levels.

The region also has huge hydroenergy potential. Estimates show that just over 10% of the hydropotential are currently utilised. Consequently, it gives an ample opportunity to meet the growing demand of the region for electric power through the use of relatively cheap hydro-power resources, provided this does not conflict with the irrigation needs of the region's countries.

Geographically an uneven distribution of energy resources could represent the following picture: a large part of proven recoverable coal and oil reserves is found in Kazakhstan, while Kyrgyzstan and Tajikistan are the best endowed in hydropower, with natural gas reserves more evenly divided between Turkmenistan, Uzbekistan and Kazakhstan (Annex 4.1b).

The geographical structure of fuel and energy production and consumption in Central Asia shows that Kazakhstan and Uzbekistan are to account for more than 80% of the total production and consumption each, with Kazakhstan being the largest producer of primary energy in the region (oil and coal), and Uzbekistan topping the list of consumers (oil, gas and electricity, Annex 4.2).

Availability and accessibility of certain categories of primary energy in Central Asian countries have largely determined their consumption structure. Thus, Kazakhstan also mostly consumes coal, Kyrgyzstan and Tajikistan - hydro-power, and Turkmenistan and Uzbekistan - oil and natural gas. Comparative data on consumption structure for the whole region by type of primary energy resource is shown in Table 4.1.

Table 4.1. Structure of Regional Energy Consumption, %

	1992	1999	2002*
Coal	29.5	22.3	23.3
Oil and oil products	29.8	21.3	19.4
Natural gas	37.9	53.1	56
Hydro power	2.2	3	3
Net import	0.6	0.3	-1.7

Source: Diagnostic Report on Energy Resources in Central Asia; * calculations based on IEA statistics

Natural gas accounts for more than a half of total energy consumption in Central Asia, with two thirds of it consumed by Uzbekistan. Coal comes second, with more than 90% consumed in Kazakhstan. The region's hydroelectric energy resources are concentrated in Kyrgyzstan and Tajikistan which produce nearly two thirds of all hydropower. In addition, there are some

differences in energy consumption by country and the type of energy resource. For instance, in Kazakhstan, petroleum products are mostly consumed by industrial enterprises, whereas in Kyrgyzstan, Tadjikistan and Uzbekistan the main share of consumption falls to transport. Coal is the basic fuel used by power stations in Kazakhstan, accounting for over 70% of the total power generation. The electric power sector in Kyrgyzstan and Tajikistan is based on hydropower, while natural gas is the main input in the electric power stations of Turkmenistan and Uzbekistan. Industry and public are the main consumers of electric power in the region.

Let us now touch upon the issue of energy interdependence between the republics. This factor is crucial, since it had an influence on inter-state relations in the past and will obviously sustain in the future. The logic of regional cooperation is also much determined by this factor.

*“...In Central Asia Uzbekistan takes a central place from the point of view of geopolitical location, and the republic has thus a potential to provide equality and balance of powers, as well as to create a basis for cooperation in the region. The territory with existing and potential reserves of natural resources reinforces its particular position on the political and economic map of the world”.*²¹⁷

*“Hydroenergy capacities in the republic are not used to a full extent. The fuel and energy complex of Uzbekistan not only meets the increased domestic demand for energy resources. Since many years Uzbekistan has been supplying its natural gas to other countries too”.*²¹⁸

Uzbekistan is the only republic which has borders with all the republics of the region. If on the one hand, the republic could serve as a hub of intraregional relations, on the other hand the country itself becomes largely dependent on its neighbors. Uzbekistan has been the largest gas producer in the region in the last years which allowed for some export to be available to the neighbor states: Kazakhstan, 900 mln. – 1.2 bln.m³, Kyrgyzstan - 1.1 bln.m³, and Tajikistan 500 mln.m³ on average²¹⁹ (Table 4.2.). Gas is mainly supplied through the Soviet-time Tashkent-Bishkek-Almaty gas pipeline (capacity almost 22 bln.m³) which runs through northern Kyrgyzstan to Southern Kazakhstan, and Gazli-Shimkent pipeline (13 bln.m³) (Annex 4.3).

²¹⁷ Translated by the author from I.Karimov (1997) Uzbekiston XXI asr bosagasida: havfsizlikka tahdid, barqarorlik shartlari va tarraqiyot kafolatlari. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.600. The President’s book contains a specific chapter elucidating the natural resource potential of the republic.

²¹⁸ Translated by the author from I.Karimov (1993) Uzbekiston – bozor munosabatlariga otishning oziga xos yuli. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. p.95.

²¹⁹ Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>

Table 4.2. Major Gas Export Markets of Uzbekistan

	1996		1997		1998		1999		2000		2001	
	Mln. m ³	Share, %	Mln. m ³	Share, %	Mln. m ³	Share, %	Mln. m ³	Share, %	Mln. m ³	Share, %	Mln. m ³	Share, %
Kyrgyzstan	1039	17	934	12	1158	31	598	13	775	14	504	12
Kazakhstan	523	8	1829	23	1831	49	1398	31	1355	24	945	22
Tajikistan	563	9	882	11	755	20	747	16	729	13	416	10
Ukraine	4037	66	4253	54	-	0	1788	39	2759	49	2463	57
Total	6236	100	7971	100	3744	100	4530	100	5618	100	4328	100

Source: Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003. p.26.

Kyrgyzstan has relatively small gas reserves, totally estimated at about 5,5 bln.m³. Since Independence, domestic gas production declined from 0,097 bln.m³ in 1992 to 0,014 bln.m³ in 2000. As a result, the northern territories of Kyrgyzstan are dependent on natural gas imports from Uzbekistan, while Turkmenistan supplies gas to the Southern part of the country.²²⁰

Regardless of its huge gas reserves, the gas sector of Kazakhstan remains underdeveloped. Especially, the sector's development is hampered by lack of infrastructure. While deposits are mainly located in the western part of the country, the large consumer areas are located in the north and south. Although the structure of energy consumption is quite contrary to that of Uzbekistan (with 75% of coal and only about 15% for gas), lack of internal routes connecting the gas fields in the west to industrial and residential consumers in Almaty, Djambul and Shymkent, made some regions strongly dependent on Uzbekistan's gas supplies. With 2000, natural gas consumption of more than 13 bln.m³, Kazakhstan imports about a third of its natural gas needs, mainly from Uzbekistan and Russia.

Uzbekistan is the largest part of the Central Asia Power System (CAPS) which was developed in Soviet times and completed in 1991. Uzbekistan generates 51% of the total power in CAPS, Tadjikistan – 15%, Kyrgyzstan – 14%, Turkmenistan – 11%, Kazakhstan – 9%.²²¹ The Unified Dispatch Center (UDC) is located in Tashkent and responsible for maintaining the balanced and synchronized operation of the power transmission and distribution systems of the five Central Asian republics. Yet, an ad-hoc inter-state Central Asia Power System Council was set up in the early 2000 consisting of the local officials from respective energy bodies in each country. A number of sessions have been already held whose main tasks was to tackle to the general coordination of power energy consumption and production throughout the region via sustainable supply and transmission of energy between energy-rich and energy-

²²⁰ Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/contents.html>

²²¹ Mavlany J. The Energy Sector of Uzbekistan. Business Information Service for NIS, 18 June, 2001

poor regions.²²² In addition, it was confessed that the development of adequate legislative documents to enhance the role of this new organ in addressing energy problems across the region. Since both the CAPS and UDS are currently in need of upgrading and modernisation to avoid electricity losses, it would also require close interaction on the regional level to attract foreign assistance. Recently, the Asian Development Bank approved \$600000 project for modernisation of electricity system in Uzbekistan and Tadjikistan which is expected to increase energy efficiency in the entire Central Asian energy system.²²³

Uzbekistan is an exporter of electricity in Central Asia, though it also imports electricity for domestic needs. In 2002, Uzbekistan produced more than 49 bln.KWh of electricity, of which about 1 bln.kWh was exported to Tadjikistan, Kyrgyzstan, and Kazakhstan. But it is the small countries Kyrgyzstan and Tadjikistan which possess untapped hydropower potential, 10% of which is only used so far. Gas and electricity exports to Kyrgyzstan in winter help Uzbekistan obtain excessive water and electricity from Kyrgyzstan in summer periods. The given process is strongly linked to Intergovernmental Irrigation Agreements between the two countries concluded regularly on bilateral basis.

Uzbekistan, in turn, is dependent on the other republics too in that it concerns their infrastructure facilities. The republic has to cross the neighboring countries, so that to keep up its exports and imports activities. There are the two pipelines - Central Asia-Center and Bukhara-Ural going back in Soviet times. The first of them brings natural gas from southern Uzbekistan and goes to North-Western direction through the territory of Western Kazakhstan, and further to the north finally joining the Russian pipeline system. The second pipeline is used little. Both pipelines are in poor state and need modernisation. Kazakhstan and Turkmenistan have already invested into the modernisation of their own parts, since both of them express keen interests in getting it restored. For Turkmenistan, it is almost the only opportunity to maintain its high gas export level, while Kazakhstan is well positioned to rely upon transit fees.²²⁴

In turn, Uzbekistan supplies gas to Tadjikistan partly as a fee for both rail transit services and the use of a transit pipeline which crosses the Leninabad region in northern Tadjikistan and links Uzbekistan's regions in Ferghana Valley with its Bukhara natural gas fields in the south

²²² Press Release of Kazakhstan Electricity Grid Operating Company On the Results of the Central Asian Integrated Power Grid Council 45th Session of 13 May 2002.

http://www.kegoc.kz/index.php3?numberPage=11&lang=eng&parent_id=1089876325

²²³ Asian Bank to Support Uzbek Government's Energy Saving Policy. www.uzreport.com. 13 March 2003

²²⁴ According to some data, Kazakhstan's benefits from such fees may run up to \$400 mln. per year. Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/contents.html>

and west.²²⁵ Therefore, exports advantages to supply energy resources within the region are intertwined and balanced with the relatively unfavorable geographical location and dependency of Uzbekistan on regional infrastructure to reach the third countries. Therefore, it is a full set of political and economic factors, both domestic and regional, which could determine the essence of advantages/disadvantages of any state in the regional scale.

4.2. Common Development Challenges

The republics of Central Asia consider their resources as a blessing which could provide necessary conditions for sustainable economic growth, efficient market-oriented reforms, social welfare and comprehensive integration into the world community. But the most period of the post-independent development was marked by general decline in both production and consumption of various types of energy resources. The main factors explaining those trends could include the whole set of macroeconomic, structural, political and geographical factors.

First and foremost, all the states had to survive severe industrial falls resulted finally in the general economic downturn which reduced solvent demand for energy, especially strong in Kazakhstan and Turkmenistan. The break-up of long-standing economic links including in the power industry of individual countries and limited access to foreign markets are also among the factors included in the given group. The latter is closely correlated with the specific geographical situation of the countries lacked the opportunity to bring their products to the world markets.

In addition to uncertainties in the first years of independent development in using the traditional route to reach world markets through Russia which had plunged into domestic socio-political and economic turbulences, all other attempts, including those to preserve a common economic space in the CIS were mostly ineffective. Besides, new priorities in the Russian policy to avoid a burden of the former peripheries affected the whole aspects of bilateral relations, further reinforcing centrifugal trends across the entire post Soviet space.

In addition, some developments in national policy of the regional states were also the result of the external and internal factors. Even among relatively rich republics, resource distribution and their contribution to national income was quite controversial. Turkmenistan has the second-largest natural gas reserves in the CIS. However, due to declared economic and

²²⁵ According to data available, out of the total gas supplies to Tadjikistan, about 200 mln.m³ cover payments for rail services, and 160 mln.m³ for pipeline tranzit. See: Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003.

political neutrality, which gradually transformed into self-isolation, the republic did little well with domestic reforms.²²⁶ The economic growth was largely explained by huge exports of primary natural gas export, but not with qualitative changes in the economy. According to official data, the share of energy in total exports for the last years has been not less than 80%, the trend which is seemingly to sustain in the near future.²²⁷

In the past decade, the issues of energy supplies from Uzbekistan to Kyrgyzstan and Kazakhstan were hindered by a number of difficulties. In particular, the difficulties are related to water issue, namely for some countries water is a source of energy (Tadjikistan and Kyrgyzstan), while for the others it is a vital element in agricultural production (Uzbekistan and Kazakhstan). Lack of water resources and natural disasters significantly pre-determine the issue of energy exchanges in the region. As a result, pricing of energy exports has lost much of its economic meaning, frequently being inconsistent and politicized and subsequently exacerbating the situation.²²⁸ Although mutual supplies of energy among countries were mostly based on intergovernmental agreements, they were repeatedly violated, mainly for economic reasons, but also due to drought seasons. In the last years, because of disagreements over prices and the debt of Kyrgyzstan for the gas received, the regional states were seeking opportunities for extra gas supplies. Thus, Kyrgyzstan wanted some supplies from Russia, while Kazakhstan intended to develop its own Southern gas fields (Amangeldy and Airyktau) to meet domestic demands. By doing so, Kazakhstan plans to be independent from Uzbekistan's gas supplies by 2005.²²⁹ It seeks for opportunities and investment to reconstruct existing, as well as to build new electricity lines, especially in electricity deficit Southern areas making dependency on electricity imports less significant.

However, though these efforts may have been driven by national priority and security concerns, it is going to contribute little to regional energy developments in the longer run. In particular, Russia may express weak interests in the gas projects in Kyrgyzstan which because of its mounting external debts could hardly guarantee stable payments for the supplied gas. In

²²⁶ Pomfret R., Anderson K.H. (1997) Uzbekistan: Welfare Impact of Slow Transition. Working Paper No 135, World Institute for Development Economics Research, The United Nations University.

²²⁷ S.Tsalik. Caspian Oil Windfalls: Who Will Benefit?, Caspian Revenue Watch

²²⁸ For example, the price for southern Kazakhstan was \$35-40 per 1000 m³ of gas, mainly for cash, while for Kyrgyzstan ranged between \$40 and 54 per 1000 m³ in 2001, with half payment each in cash and barter. See: Uzbekistan. Energy Sector: Issues, Analysis, and an Agenda for Reform. World Bank, June 2003. p.27.

Although it remains uncertain whether it is barter deals that pre-determine higher prices for Kyrgyzstan, or it is higher prices forcing to favor such a way of transaction, their adverse affect is evident for both states.

²²⁹ According to government's plans, Kazakhstan plans to produce 35-40 bln.m³ by 2010 and about 70 bln.m³ by 2015. Because of relatively low levels of domestic gas consumption, the republic intends to be another huge gas exporter in Central Asia. See: S.Tsalik. Caspian Oil Windfalls: Who Will Benefit?, Caspian Revenue Watch, p.151

such case, economic costs may bring about long-run political consequences connected with the possible, not always adequate claims of the Russian business on economic assets of indebted energy economic units in Kyrgyzstan. As for Kazakhstan, its southern gas fields may not have sufficient reserves in the long-term perspective. According to some estimates, they may be sufficient for just over a decade only.²³⁰ The same is situation with Tadjikistan exacerbated by overconsumption and non-payments by individual consumers, but whose dependency on gas supplies from Uzbekistan, and partly from Turkmenistan remains high.

Finally, structural challenges have much to do with the internal developments in the energy sectors of each single country. Yet some similar features of these challenges affected their development could be set out. They were mainly as follows:

- high dependency on imports of power equipment that can be explained by the previous division of labour;
- obsolescence of a large portion of capital equipment in the fuel and energy industry;
- lack of investment, especially in power industry;
- increasing share of energy in the cost of industrial output of Central Asian countries, resulting from growing costs of energy and leading to a loss of competitive advantage in both external and domestic markets;
- the difficulty of finding staff for the fuel and energy industry and the power engineering industry;
- lack of information on the overall availability of energy resources throughout the region;
- high energy intensity of economy and, as a result, significant waste of fuel and energy across sectors.

To sum up, all the countries of the region met the independence with inefficient and uncompetitive domestic energy industries as a legacy of the Soviet past. Most of the equipment was outdated causing little efficiency in the use of domestic raw materials. Energy intensity reflecting the use of energy resources to produce \$1000 of GDP was several times higher than in major industrialized countries and regions (Figure 3.1, Sub-chapter 3.2.1.4.), though the range of energy intensity was different in various countries, with Kazakhstan and Kyrgyzstan having reduced the given figure and the others having seen an increase in the energy intensity. But it should be noted that above-mentioned reductions in energy intensity in some countries occurred mostly as a result of a decline in industrial output and freight and

²³⁰ EIU. Uzbekistan Country Report 2000

passenger turnover in the public sector, as well as a fall in energy consumption for defence needs, rather than through efficient energy-saving policies of Central Asian countries.²³¹ Besides, energy shortage of industry, households and the communal sector through disruption or failures in energy supply could be seen as another factor explaining this process. In other words, these reductions cannot yet be accepted as an outcome of sound and efficient fuel and energy policy measures to enhance the economy and population to saving and more efficient activities, but most probably were a consequence of decline in economic development and living standards.

In the light of the aforementioned trends, currently there are no long term contracts to provide price stability, and the opportunities for entering into such contracts are normally slim, given the general knowledge in the industry and the region about unreliable production levels and therefore, supplies. Moreover, for Uzbekistan and other concerned Central Asian states to favor even economically the most viable energy route in the Southern direction looks uneasy in these terms. In particular, it will require (a) first and foremost, guarantees of security and stability in the Southern countries (Afghanistan, Pakistan); (b) be competitive with potential contenders (such as Iran, or Afghanistan, for example, with their own mineral reserves); (c) the restoration almost fully destroyed energy infrastructure in Afghanistan;²³² (d) huge foreign investments; (e) capabilities of export markets to pay for the energy supplied.

4.3. Intra-regional priorities

The following two strategic intertwined goals in the energy field are going to determine sustainable development of the regional countries in the future:

- self-sufficiency of the region in energy resources;
- development and diversification of pipeline network system, both inside and outside the region, securing sustainability of export routes from Central Asia.²³³

²³¹ Diagnostic Report on Energy Resources in Central Asia, <http://centrasia.cintech.ru/energy-eng.pdf>

²³² According to some estimates, only 6% of population in Afghanistan have access to electricity making domestic power market attractive for Central Asian export. Yet inadequate electricity infrastructure (transmission lines of low voltage, poor connections to Central Asia's electricity lines) in couple with low purchasing power are among the main setbacks to commercial sales of energy. Uzbekistan's coal company UzbekUgol also supplied 6500 tons of coal in the first three months of 2002 claiming that the total absorptive capacity of the Afghan market might make up about 200000 tons. Yet payment issues remain one of the main aspects in such deals.

²³³ This aspect is scrutinized more closely in the next subchapter.

The energy self-sufficiency of the region depends not only on its primary energy base but also on the ratio between its annual generation and consumption. The ratio for 1999, for instance, exceeded 1.0 for the whole region (1.43), with Kazakhstan achieving 1.67 and Turkmenistan, 2.33. Kyrgyzstan and Tajikistan, who are net importers of energy resources, are obviously less self-sufficient, while Tajikistan had the worst rating (0.4).²³⁴ Yet in terms of the hidden potential for expected economic growth, with a further emphasis to continue with industrialisation in each country, consumption of energy will steadily rise and therefore, require sustainable production patterns too.

Nevertheless, past development has seen a decline in the energy security for the region. Some critical measures are thus needed to reverse the trend in individual countries and the entire region. These measures, in particular, may include:

- policies seeking to increase intensive economic use of domestic energy potential through construction of new fuel and energy processing facilities, enhancing the energy efficiency of the economy;
- intensification of efforts to involve bi- and multilateral foreign investors in prospecting and developing new hydrocarbon deposits, building pipelines and power grids, building new generating facilities for oil and gas networks and overhaul of existing ones together with their infrastructure;
- the search for partners and new transport routes for energy exports from the region;
- market reforms in the energy sector and improvements in tariff policy;
- strengthening of cooperation in energy across the region.

Both the energy sector and the entire economy of the region face a major task of steering their efforts towards sound and efficient use of available fuel and energy. The rational and efficient use of fuel and energy in terms of its current status and likely development, would imply, first and foremost, the optimisation of the regional balance of fuel and energy and, more directly, enhanced efficiency of fuel and energy use at all stages of the energy cycle from the extraction of raw materials to the consumption of final energy in all economic sectors.

Energy efficiency in Central Asian economies could, in particular, be improved through:

- the recording and monitoring of fuel and energy consumption;

²³⁴ Diagnostic Report on Energy Resources in Central Asia, <http://centrasia.cintech.ru/energy-eng.pdf>

- further measures on persistent modernisation and upgrading of energy-consuming equipment;
- improvements in the location of production networks by reducing the distance from the producer of energy to its consumer;
- reduction material and energy intensity in manufacturing, including through improvements in the quality of raw materials and large-scale recycling of production waste;
- using more efficient and environmentally clean technologies in final consumption.

In other words, better efficiency is strongly correlated to adequate policy measures on energy conservation. Central Asian countries have built up significant potential for energy conservation²³⁵ and need to proceed to its objective assessment and efficient implementation so as to facilitate development through conservation of energy, stimulate economic growth and reduce environmental tensions. Significant savings of fuel and energy could be achieved through economic restructuring that would focus on increasing the share of less energy-intensive production units. The above measures would require sound investment and a solid legal framework as well as trained and competent personnel and broad-based information campaign to facilitate participation in conservation measures of both consumers and producers of fuel and energy.

In addition to the aforementioned steps at the national level in each of the countries, optimum use of the resource potential could and should be achieved through broad intra-regional cooperation in the energy sector. This condition is indispensable with any efforts seeking to strengthen the self-sufficiency of Central Asia in terms of energy supply, increase its energy export potential, save investment resources for further increase in the production capacity of fuel and energy complexes and for fuel and energy imports, and to reduce environmental pressures both regionally and globally. In particular, these policies should be directed on:

- establishment of regional energy market to secure guaranteed and economically viable supply of required amounts of energy to meet the needs of the economy and population of the region;

²³⁵ According to some estimates, these figures might amount 30% of the overall primary use of energy in the late 1990s. See Diagnostic Report on Energy Resources in Central Asia, <http://centrasia.cintech.ru/energy-eng.pdf>

- joint funding of projects involving the exploration and development of new fuel deposits, building new hydroelectric power stations (and modernising existing ones) as well as identifying and establishing new energy transport routes;
- avoidance of setbacks in non-discriminatory transit of energy through the region for intra-regional and external needs;
- efficient intra-regional energy exchange as a prerequisite for the utilization of available energy capacity at maximum efficiency;
- sustainable operation of Central Asian power grids that would enhance reliability of power supply at the national and regional levels;
- development and implementation of concerted policies in external energy markets;
- implementation of wide-ranging energy-conservation programs on a national scale and development of intra-regional cooperation in this sphere (harmonisation of laws and regulations, information exchange, etc.);
- coordination of regional efforts for the development and implementation of common investment policy, with a particular emphasis on foreign capital, to undertake regional and national structural reforms.

The analysis has revealed that a number of factors stood behind the decline in Uzbekistan's exports of both natural gas and other energy products over the last years. This decline particularly, occurred due to (a) specifics of domestic policies on self-sufficiency and the necessity to meet first and foremost domestic demand; (b) declining domestic production and structural challenges; (c) deteriorating infrastructure facilities, particularly gas transmission; (d) inter-state disagreements on price and energy supplies across the region exacerbated domestic challenges of political and economic character. Yet Uzbekistan needs and still capable to improve the reliability and timeliness of energy, primarily gas supply to its neighbors, otherwise the chances to loose the markets seem to be high. For this purpose, the countries must find the way to improve current mechanism of energy trade, favoring commercial conditions and overcoming ineffective barter transactions. Subsequently strengthening economic criteria, one also needs to reduce and ultimately de-link it from intergovernmental agreements on irrigation and transit services between the countries. It is also critical to enhance direct horizontal linkages between the energy consumers and producers throughout the region by holding talks and signing agreements between the immediate parties concerned in each country. The expansion of private investment into sector

development in Uzbekistan would be in line with the facilitation of their role in further export development within and beyond the region.

Central Asia, thus, may possess that energy potential which could be enough for the region to be self-sufficient in the future. It is true that further increase in fuel and energy output cannot be absorbed by intra-regional markets only. It means that sustainability and progress of the energy sector and the whole economy are expected to be much dependent on the possibilities of export expansion, searching for new markets and a diversified pipeline network to and out of the region. But this task looks to be uneasy, especially in terms of geopolitical and geoeconomic imperatives around Central Asia.

4.4. Growing International Interests

4.4.1. General Patterns

The geopolitical and strategic importance of Central Asia was reiterated a few times by both regional and non-regional politicians and academicians on different levels. The President of Uzbekistan I.Karimov, for instance, related this significance to the system of global politics.

“The balance of power on the vast space across the world depends, to a considerable extent, on the path which the new states of Central Asia will choose to move ahead. And those who participate in the development of a qualitatively new order of international relations today can not have confirming this fact...Uzbekistan is a strategical centre of the peninsula that includes extremely rich fields of oil and gas of the Persian Gulf, the Caspian Sea, and the Tarin Basin. Therefore, in terms of the world’s shortage of energy, the peninsula is surrounded by the energy reserves which are going to play a key role for Eurasia and the entire world in the nearest future”.²³⁶

Equally, former US President National Security Assistant Zb.Brzezinski suggested that the region’s perspectives in the global international network of interests would be, among other factors, defined by its mineral-resource base. To put it literally: *“Availability of the resources of the region represents those goals which rouse national ambitions, stipulate for corporate interests, revive historical claims, restore imperial intentions and rekindle international rivalry...”*.²³⁷

²³⁶ Translated by the author from I.Karimov (1997) Uzbekiston XXI asr bosagasi: havfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Extract from the collection „Uzbekiston – buyuk kelajak sari“. Tashkent, 1998. pp.421-424.

²³⁷ Translated by the author from Tsentralnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost. Group of authors (2002), Tashkent. p.89. Original quotation from Brzezinski Zb. The Grand Chessboard.American Primacy and its Geostrategic Imperatives (Basic Books –Harper Collins Publishers, Inc, 1997).

As it has been emphasized before, the resource-rich countries are expected to have more opportunities for economic and socio-political development provided on appropriate domestic policy of the government. That is why, after the collapse of the Soviet Union, the ex-Soviet republics of Central Asia, especially those with rich mineral resource base, have been trying to exploit their natural resources as the means for providing economic and political environment for the further development. However, Central Asia's remoteness from the main world markets, as well as lack of pipeline infrastructure to export strategic energy resources (oil, gas, and electricity) to consumers outside the region, was a major challenge to those efforts. In addition, since the region was integrated into the common economic system under the Soviet rule, all the states in many ways remained dependent on each other, including energy supplies.

On the other hand, increased world demand, especially from industrially developed countries of West and Asia, for energy resources from Central Asia, contributed to the fact that Caspian basin and Central Asia together are considered as new, tremendous potential source of energy products in the nearest future. Even though the accurate estimates of energy base of Central Asia are quite at variance in the world reports, sometimes even speculative, they might be impressive enough to attract much of international attention in the past decade.

At the same time the substance of the issue goes obviously much beyond the size of proven oil and gas reserves requiring some geopolitical scrutiny in terms of a new diversified system of pipelines needed to be built out of the region. The problem is how to give or not give Central Asia the possibilities to mitigate its land-locked situation by bringing its resources to the more diversified markets of final energy consumers. This issue is surely of priority significance for any of Central Asia's republics and for the region as a whole.

The President I. Karimov's words are adequately reflecting this desperately desired way in a labyrinth with multiple choices to capture the region: *"The clear thing is that only if stability and geo-strategic balance are retained, the given region may face consequent and sustainable development and become an appropriate partner for the world community... The new states intend to be "equal among equal", seeking for being integral part of the world"*.²³⁸

What makes this task not so easily attainable is that international interests in Central Asia are characterized by a complex diversity of geopolitical and strategic goals of the third countries stipulated by their national foreign policy agenda. It subsequently reflects in the scale and

²³⁸ Karimov I. (1997) O'zbekiston XXI asr bo'saga'asida: xavfsizlikka tahdid, barqarorlik shartlari va taraqqiyot kafolatlari. Collection of works "Uzbekiston – buyuk kelajak sari", Tashkent, 1998, p.417-422.

level of involvement in regional trends in Central Asia. The principle “Who will control the transport and energy infrastructure, will be able to take over the control over the “live artery” of the region” caused a hidden rivalry between main international actors throughout the most part of the last decade. In other words, it was evident that international powers were seeking commercial interests in couple with political, sometimes even outweighing interests of the regional states. Under such conditions, the energy endowment of Central Asia will not mean automatic social prosperity, as the sustainability and development of energy complex is going to fall under pressure of not only direct economic issues, but also a set of socio-political ones.

Thus, the development of energy resource base in the region does not confine to its local production only. The biggest challenge for foreign investors is still how to transport these resources to foreign markets. In terms of Central Asia’s land-lockedness, the determination of pipeline routes acquires a particular geopolitical meaning. In the last decade, there were only few possible choices to transport Central Asia energy resources outside the region. Yet the current century is expected to bring much new in energy developments across the region. These changes should be obviously scrutinized through the prism of higher interests to the region from main regional and non-regional players; national factors of the past developments in those states; intensification of bi- and multilateral relations of the Central Asian states with these powers; and the level of cooperation or rivalry between these major powers. For this purpose, let us set out some main factors to represent the established network of these interests with a subsequent impact on regional energy patterns.

The USA

One of the key reasons of new trends and developments in Central Asia is without doubt the **US policy** relatively to the region. There are various views among US policymakers and academic circles on the types and levels of the American involvement into the region. These arguments even favor specific countries, namely Uzbekistan and Kazakhstan, which should allegedly receive the most US attention for comprehensive strategic (first country) or narrow commercial (second country) reasons. A closer look at US foreign policy, however, reveals its adherence to so called “full-spectrum dominance”. Reflecting the whole specter of political, military and economic, including energy implications, these interests could be summarized in the following main areas. They are: security, including reinforcement of independence of each of the Central Asian states and the fight against the terrorism, extremism and drug trafficking; assistance in pursuing market economic and democratic reforms; integration into the world

community, including enhancement of active regional cooperation; and national energy interests.²³⁹

As the US sets are convinced, such an approach could finally serve to US national security concerns by fostering comprehensive development of the states, bring prosperity and economic growth, and alleviate the social distress exploited anti-Western extremist groups to fill in the economic and ideological vacuum.²⁴⁰ Besides U.S. support for free market reforms directly serves U.S. national interests by opening new markets for U.S. goods and services and sources of energy and minerals. The Export-Import Bank (Eximbank) has obligated funds for short-term insurance, loans, or guarantees for export sales of industrial and agricultural equipment and bulk agricultural commodities to all the states except Tajikistan.²⁴¹ The Overseas Private Investment Corporation (OPIC) has signed agreements with all the Central Asian states on insuring U.S. private investments overseas, and has obligated funds for financing or insurance in all the states except Tajikistan.

On June 1, 2004, the U.S. Trade Representative signed a Trade and Investment Framework Agreement with ambassadors of the Central Asian states to establish a U.S.-Central Asia Council on Trade and Investment. The Council will meet at least yearly to address intellectual property, labor, environmental protection, and other issues that impede trade and private investment flows between the United States and Central Asia and that hamper intra-regional trade and economic development.

The USA increased and expanded the scale of military and development assistance to Central Asia after the events of September 11, 2001. The figures show that cumulative foreign aid budgeted to Central Asia for the period of 1992 - 2003 amounted to \$3.2 billion, or about 13% of the amount budgeted to all the Eurasian states, reflecting the lesser priority given to these states prior to 9/11. During 2002 spending for Central Asia was greatly boosted in absolute amounts (\$584.13 million) and as a percent of total aid to Eurasia (25%). The aid amount for 2003, however, appeared to return to about the previous percentage level (Table 4.3.).

²³⁹ Osnovnye Napravleniya Tsentralnoaziatskoy politiki SshA. The Magazine Tsentral Asia and Caucasus, 1997, No 8. http://www.communicate.se/cac/magazine/08_1997/st_13_kolinz.html

²⁴⁰ Nichol J. Central Asia: Regional Developments and Implications for U.S. Interests. Congressional Research Service, the Library of Congress. p.2. www.fas.org/man/crs/IB93108.pdf

²⁴¹ For example, in 2002 the Eximbank of the USA approved the guarantees for export equipment and related products and services at \$78 mln. for Navoi Mining Complex in Uzbekistan, and another \$20 mln. for export of mining tracks and other construction equipment to replace the out-of-date equipment in Navoi complex. Eksimbank SShA predostavlyaet garantii v podderjku eksporta oborudovaniya dlya NGMK. www.uza.uz, 12.02.2003

Table 4.3. U.S. Foreign Assistance to Central Asia
(in millions of dollars)

Country	Cumulative Funds Budgeted FY1992-FY2003 ^a	FY2003 Budgeted ^a	FY2004 Estimate ^a	FY2005 Request ^c
Kazakhstan	1,054.4	100.43	68.6	40.22
Kyrgyzstan	697.35	54.71	44.08	39.54
Tajikistan	550.59	49.36	33.47	36.35
Turkmenistan	227.71	10.98	8.66	9.28
Uzbekistan	595.33	83.46	53.94	53.22
Total	3,188.83 ^b	306.77 ^b	208.75	178.61
Percent	13	15	14	27

a. FREEDOM Support Act and Agency funds.

b. Central Asian Regional funds are included in the total.

c. FREEDOM Support Act and other Function 150 funds, not including Defense or Energy Department funds; the FY2004 estimate and FY2005 request exclude funding for exchanges.

Source: Nichol J. Central Asia: Regional Developments and Implications for U.S. Interests. Congressional Research Service.

The aforementioned can bear at least two implications. On the one hand, it probably was a swift gesture of gratitude for the support from Central Asia for the US operation in Afghanistan. Yet in the longer run, the USA may attempt to seek for better security not only in terms of global fight against international terrorism, but also as the necessary condition for further economic liberalization and the development of Caspian-Central Asian energy resources.

The latter argument has much to do with a number of energy and geopolitical concerns. The USA leads the world in oil consumption, with about 20 mln.barrels a day half of which is imported oil. Even when the US found that dependence on oil imports threatens then US national security, American energy policy has changed little for the last decade. Instead of reduction in oil imports, the USA are seeking diversification of supply sources to avoid dependence on a single or a group of suppliers.²⁴² In this respect, speculations on Central Asian energy resources gave the food for thought that the region was important to the extent to keep the oil prices down in international perspective. It may look like that after military intervention in Iraq, Central Asia has to somehow fell off out of energy attention of the USA. Yet one must not forget that since significant increases in oil prices and inability of OPEC, as the main traditional partner of the USA to manage price volatilities on main world markets, it remains in strategic US interests to keep an eye on every possible source of energy out of the destabilized traditional Middle East. In addition, investments already made by US companies

²⁴² The lion's part of oil import comes from Saudi Arabia.

in Central Asia are huge and will most likely remain under the spotlight of U.S. support and protection.²⁴³ The American estimates of Central Asian energy reserves which are the most promising, may speak in favor of their strategic interests for diversification of its energy import through the globally pursued strategy. Not at least, energy interests of the USA in Central Asia are in compliance with its strategic interests to resist and counterbalance any dominant presence and expansion of geopolitical and geoeconomic influence of other powers, such as Russia, China and Iran, in Central Asia.²⁴⁴

Russia

The **Russia's interests** in the region were pushed by a number of economic and political events related to Afghanistan, Caucasus, the CIS, as well as by the active US engagement in the development of energy projects in Central Asia during the last decade. Just a few years ago Central Asia had largely fallen off the Moscow's field of interests. There was a period, especially in the first half of the 1990s when it seemed Russia had sort of forgotten its interests in the region devising its foreign policy basically towards swift and comprehensive integration with the West. It was pursuing a much less apparent policy in relations with the Central Asian region and seemed to be allowing them to go their own way to a large extent.²⁴⁵

The given situation has yet been cordially changing since the end of the 1990s marking a new milestone in Russia-Central Asia relations. The current Russian government has made not only a clear declaration that the entire CIS, including the Central Asian region, is of vital interest in foreign policy,²⁴⁶ but already kept up its promises with a number of concrete steps in political, military and economic areas. The following measures may only speak in favor of the whole seriousness of the Russian intentions towards the region, both in time and space, as well as on the level of involvement.

²⁴³ As much as \$30 bln. have been invested in the development of oil and gas fields in Kazakhstan, Uzbekistan, Turkmenistan and Azerbaidjan. Energy Information Administration, www.eia.gov.

²⁴⁴ Nichol J. Central Asia: Regional Developments and Implications for U.S. Interests. Congressional Reserach Service, the Libraray of Congress. p.2. www.fas.org/man/crs/IB93108.pdf , p.14; Bondarets L. Voenno-Politichekiye Aspekty Interesov Vedushih Derjav Mira v Tsentralnoy Azii, in "Interesy ES, KNR, Rossii i SshA v Tsentralnoy Azii". Round Table Materials, Bishkek, 2004, p.114

²⁴⁵ On April 1 1992 Superior Council of the Russian Federation even declared that protection of territorial integrity and sovereignty of any state is the issue of its own. Moldaliev O. Borba za Vliyanie v Tsentralnoy Azii. In "Interesy ES, KNR, Rossii i SshA v Tsentralnoy Azii". Round Table Materials, Bishkek, 2004, p.31. Later also, the countries of Central Asia were forced to face a controversial politically motivated economic choice, whether to stay or leave common currency area which finally led to introduction of independent national currency units.

²⁴⁶ Address of President of Russia V.Putin at the Plenary Session of the Russian Federation Ambassadors and Permanent Representatives Meeting, July 12, 2004, Moscow, Foreign Ministry http://President.kremlin.ru/eng/speeches/2004/07/12/1323_74425.shtml

It was an unprecedented step, when Moscow had moved to join Central Asian Cooperation Organization (CACO), a purely Central Asian grouping in June 2004 in Astana. The unanimous support for this decision from Central Asian states now allows Russia to take part in economic, political and military regional processes on a multilateral basis. Despite the assertions that “the US policy is not aimed against the interests of Russia”, the over active economic and political support of the region is of great concern for Russia.²⁴⁷ Some experts believe that membership of Russia in CACO was encouraged by an apparent attempt to check U.S. growing clout in the region.²⁴⁸

The Caspian and Central Asian energy resources and related issues on diversification of the pipeline network from the region may represent another feature of such kind of rivalry between Russia and the other countries (see map in Annex 4.3). In the past, the USSR considered oil and gas exports largely as a source of foreign exchange. This apprehension has widened largely in current terms. There is a perception that this is not just about cash foreign exchange, but also about long-run strategic interests, especially in the regions, like Central Asia, to embrace much of underdeveloped production potential and transportation of energy resources. For Russia, the energy issue in Central Asia is currently turning out to be an integral element of foreign policy, as well as a well-grounded lever to dominate in the region. It has likely much to do with the fact that Russia is now receiving more money from the export of its oil. Oil and natural gas are helping Russian ambitions and presenting the government with new opportunities that could not have been anticipated some time ago.²⁴⁹

In the given context, while expressing little support to any alternatives for energy export routes from Central Asia, Russia simultaneously lobbies the use of its own and existing pipelines by the regional energy exporters. Its recent strategy is based on the renewed intensive investments into the regional energy development, exploration, and transportation systems, currently on the bilateral basis. For instance, Russia is the largest buyer of Turkmen gas and Kazakhstan’s oil, both for domestic use and for further export through its pipelines (Annex 4.4). In April 2002 Russia and Turkmenistan concluded 25-year intergovernmental agreement on Russian purchases of Turkmen gas. According to the agreement, from 2005,

²⁴⁷ Former Assistant to the US President on Security issues Condoleeza Rice said: “Our policy is not aimed against the interests of Russia. We do not harbor any plans aimed at squeezing Russia out of there (Central Asia)”. See: Condoleeza Rice “US politics in Central Asia not directed against Russia”. *Izvestia*, 14.10.2001.

²⁴⁸ Russian Security Council Secretary I.Ivanov told the meeting in Astana that multilateral integration was supposed to face challenges of globalization. The vague statement therefore left observers wondering whether US policies in the region were seen as a principal “challenge of globalization”. Blagov S. Russia: Yet Another Central Asian State, www.atimes.com, 03 June 2004

²⁴⁹ Russia has managed not only to overcome very soon the consequences of severe financial crisis in 1997-98, but also to accumulate significant foreign exchange, mainly through the energy export receipts which at least twice as much as budgeted in the recent years.

Russia will buy about 20-30 bln.m³ of natural gas from Turkmenistan annually, from 2008 – up to 70 bln.m³ which makes Russia the main consumer of Turkmen gas, at least in the middle-run.²⁵⁰ The largest share of Kazakhstan's oil is exported through Russian infrastructure. The “northern route” which goes through the Russian port of Novorossiysk in the Black Sea, alone transports about 28 mln.tons of oil annually. Within the given project, the Caspian Pipeline Consortium was found with 11 companies, including from Russia (24% of total share), Kazakhstan (19%), Shevron Texaco (USA-15%). As the main stockholder, Russia initiated the decision to increase throughput capacities up to 67 mln.tons, in order to raise efficiency of its functioning which also implies even more Kazakh oil will be claimed.²⁵¹ In 2002 Russian “Gazprom” and Kazakh state company “Kazmunaygaz” set up a joint venture which is in charge for buying and transportation of natural gas from Kazakhstan's Karachaganak gas field to the Orenburg refining facility in Russia. In 2003 the facility refined about 5,5 bln.m³, in 2004 – 7 bln.m³. Russian “Gazprom” is urging the Kazakh side to establish another joint venture in Orenburg which would allow to transport another 8-10 bln.m³ after the third stage of Karachaganak production bloc is put into action.²⁵²

The year 2004 could be characterized as remarkable in the Uzbek-Russian energy relations. The Uzbek National company “Uzbekneftegaz” signed a 15-year Production and Sharing Agreement with Gazprom at the end of April to extend the life of the local Shakhpakhty gas condensate field in the Ustyurt region. Gazprom pledged a \$15 mln.investment. In addition, it is anticipated that according to Gazprom plans, it will have signed another PSA with Uzbekneftegaz on the development of gas condensate fields in Ustyurt region with \$995 mln. investment commitments by the end 2004. Generally, Russian Gazprom in 2003 bought 2.5 bln.m³ of gas from Uzbekistan under the agreement which is also expected to increase to 7.7 bln.m³ in 2004 and at least 10 bln.m³ in 2005. Totally Uzbekistan will provide Gazprom with 87 bln.m³ of gas in 2004 – 2012.²⁵³

Uzbekneftegaz has also signed a 35-years long Production and Sharing Agreement (PSA) with the Russian oil company Lukoil under which the partners will produce natural gas in the Kandym-Khauzak-Shady project in the Bukhara-Khiva region. Lukoil will own 90% and

²⁵⁰ Lelyveld M. Russia May Come to Terms on Gas Deals, www.times.kg, 25 September 2002.

²⁵¹ Ivanenko i. Truboprovod v Kitay Ostavit Transneft bez Tranzita. Newspaper Kommersant, 11 November 2004.

²⁵² Gazprom top officials assure the Kazakh side that the given joint project would be much more cost efficient, both in capital investments (\$200-300 mln.) and time (1,5-2 years), than plans of Kazakhstan to build up refinery facility in Karachaganak itself with 10 bln.m³ capacity. The Russian experts believe that in the latter case it would cost about \$1,3 bln. and be profitable provided that 90% of the gas refined would be sold in Western markets which are glutted enough to absorb the aforementioned volumes. See: “Gazprom” Predlagayet Kazakhstanu Sozdat SP na Baze Orenburgskogo GPZ, press.lukoil.ru, 05 July 2004.

²⁵³ Uzbekistan Hopes to Be Key Gas Exporter. <http://www.interfax.com/com?item=Uzb&a=on&id=5762680>

Uzbekneftegaz the rest 10% of an operating company which will deliver the gas. Anticipated capital costs are expected at around \$1 bln. and commercial production starting in 2007 whose peak is due to reach 9 bln.m³. Also a new refining facility is going to be built, with the first stage to be launched in 2010. Commenting on this project, Lukoil President made the following statement: *"The investment climate in Uzbekistan enables us to be confident that the company will receive the profit rate that is planned for the entire 35 years. The Uzbek leadership has taken a big step toward not only Lukoil, but also towards all Russian investors"*.²⁵⁴ It was also made known that an agreement with Gazprom on sales of gas produced had been reached according to which Gasprom would become an authorized body to decide whether to sell this gas in Russia or abroad. Given that the aforementioned projects have been the largest ones in the energy sector in Uzbekistan ever, these words may not only signal on a new momentum in Uzbek-Russian cooperation endorsed on the highest level, but also could be seen as some sort of a call to other Russian companies to take the opportunity for the reinforcement of their position in the regional context which in turn would be much in line with national Russian interests.

The small countries of the region Tadjikistan and Kyrgyzstan have also not been left without appropriate attention from Russia. In addition to military bases in these countries, Russia sought to strengthen its energy positions there too. The Russian Unified Energy Systems energy company RAO EES is the main initiator of the plans to create common energy market on the entire CIS space. There is a Russian-led ad hoc Electroenergy Council in the framework of the CIS which hold a few sessions in 2004. As a result of its recent session, Russia concluded an agreement with Tadjikistan on tranzit of 1,4 bln. kWh electroenergy to Russia, while Kyrgyzstan had already begun supplying the Southern regions in Russia with total commitments of more than 1 bln.kWh in 2004. The Tadjik Primer-Minister declared during the meeting that his country was using only 3,4% out of 520 bln. kWh total energy potential making it clear that Tadjikistan was in need of about US \$2 bln. in investments to raise its hydro energy production up to 15 bln.kWh annually. He also made known that international energy consortium on the Sangtuda hydropower station would be set up very soon, embracing Tadjikistan, Iran and Russia as its members.²⁵⁵ Visiting the Tadjik capital Dushanbe in October 2004, Russian President V.Putin surprised his audience by pledging substantial financial investment in Tadjikistan. *"The Russian side – both its state structures and private companies – intends to invest some US \$2 bln. in the Tadjik economy within the*

²⁵⁴ Uzbekneftegaz, Lukoil Sign Gas PSA. http://www.times.kg/news/Oil_&gas/Uzbekistan/2004/06/25/0054875

²⁵⁵ Tadjikistan Nameren Postavlyat Elektroenergiyu v Rossiyu Tranzitom Cherez Uzbekistan. Info Agency of Tadjikistan, www.asiaplus.tj, 12 June 2004.

next five years. I do not think any other country has, in the past 12 or 13 years, ever invested such an amount of money, or even announced plans to invest such an amount of money in Tadjikistan”, he said.²⁵⁶ In addition to this investment, RAO EES promised to invest US \$200 mln. in Tadjikistan’s Sangtuda hydropower station. The Russian Rusel aluminium company, meanwhile, pledged to invest US \$560 mln. into a dam at the Rogun hydropower plant along further investments into the largest producer and exporter of aluminium not only in Tadjikistan, but also in the whole Central Asia. An agreement was also signed between the Government of Kyrgyzstan and Russian Energy Company RAO “EES” in August 2004, according to which Russia pledged to invest about \$2 bln. USD to complete the construction of Kambarata’s two big hydropower stations in Kyrgyzstan.²⁵⁷ Being the largest company’s investment project abroad, the given deal, as well as those in Tadjikistan, may bring to Russia not only purely economic benefits from regional export of energy, but also be strategically important in terms of regional water resources management and its distribution in Central Asia.

Russia also takes part in privatization of national energy companies in the regional states which may give it some influence on the decision-making process as to regional energy trends. By now Russia has already concluded, or is going to make up long-term cooperation agreements in the energy field with each of five republics, seeing such cooperation as a lynchpin of its national priorities in Central Asia. For example, recently Russian companies Gazprom and Itera expressed their keen interests to participate in tender on privatisation of the gas-transport system of Uzbekistan.²⁵⁸ Gazprom also vowed its willingness to become a stockholder of the Kazakhstan’s gas transport system. In particular, Vice Chairmain of Gazprom emphasized: *“Kazakhstan is important for us, first and foremost, as a transit state, and therefore, we look with attention at how the Kazakhstan’s gas transport system is developing. We would like to become shareholders of the gas transport system if it is due to be sold, since it would be advantageous for both Kazakhstan and Russia, and for Gazprom as well”*.²⁵⁹ Russia is concerned about the poor throughput capacities of the Kazakh gas system. By using its facilities as a “transit state”, the Russian side favors its long-run export deals with Turkmenistan and Uzbekistan which (the states) are all part of the Soviet-time Central Asia-

²⁵⁶ Pannier B. Russia Comes on Strong in Central Asia. www.atimes.com, 19 November 2004

²⁵⁷ Siluyanova P. “Chubays Prishyol v Kyrgyziyu”, www.gzt.ru. 23 August 2004.

²⁵⁸ Gazprom and Uzbekneftegas Expand Cooperation. www.uza.uz. 18 December 2002.

²⁵⁹ Gazprom Rasschityvaet Stat Aktsionerom Gazotransportnoy Systemy Kazakhstana. Newspaper Kazakhstan Today, 05 July 2004

Centre gas pipeline bringing gas to Russia.²⁶⁰ Currently some parts of this system has already outdated, especially the Uzbek part. Russia and its “official agent” Gazprom have pledged not only to renovate the existing system, but also increase its throughput capacities from 42 bln. to 54 bln.m³ during 2004-2006, and up to 80-90 bln.m³ by 2010.²⁶¹ It does go with the Agreement on Strategic Partnership in the Gas Sector dated December 2002 between Uzbekneftegas and Russia’s Gazprom, foreseeing 5 bln.m³ of Uzbek gas supplies within the further 12 month period starting from May 2003 which may reach 10 bln.m³ by 2010 in addition to the Turkmen 70-80 bln.m³ by 2010.²⁶² So far, Gazprom imported 20 bln.m³ and 2 bln.m³ gas from Turkmenistan and Uzbekistan, respectively, in the first half of 2004.²⁶³

Thus, Russian investments in the Central Asian energy sector on different levels, either in production, infrastructure, or decision-making, may follow not only direct economic benefits, though they seem to be impressive too. Russia will most probably need more oil for a quickly growing park of cars and trucks. Presumably, Russia will also experience a rapid increase in electricity demand in its residential and service sectors, for which natural gas is likely to be the most favorable source of generation. In terms of narrow opportunities for the region to export its resources at its own, it is going to be Russia and its authorized agencies who are expected to take dominant control over the most part of the economic rent provided by these resources. Partly the benefits could also come from energy resales further at world prices, at least twice as higher as the regional ones, as well from transit. Political implications are also well perceived. Most probably Russia may have an interest in controlling Caspian and Central Asian oil and gas exports to improve her own bargaining position with Western oil investors. The stakes are access to capital and market power. The oil and gas export pipelines are the instruments giving Russia a political leverage. If Russia succeeds to preserve its influence in the energy sector of each republic, it will manage to remain influential not only in the intra-regional relations, but in those around Central Asia.

China

If we take into account the incredible economic development of the Eastern part of the world in the last decades, it becomes clear, why the eastern route is going to be of another particular

²⁶⁰ In addition, in 2002 the Russian President V.Putin brought forward an idea of establishing an Eurasian gas alliance, similar to OPEC, which would include Central Asian gas producers (Turkmenistan, Uzbekistan and Kazakhstan) plus Russia, to coordinate production and exports of natural gas. Yet despite of some initial steps, the process basically stalled, due to the reluctance of some countries, mainly Turkmenistan, to share part of national sovereignty over resources within the newly created multilateral body.

²⁶¹ Gazprom Hozaynichaet v Tsentralnoy Azii. Magazine Eurasia, June 2004.

²⁶² President Uzbekistana i Glava Gazproma Obsudili Sotrudnichestvo. www.uza.uz, 23 July 2003

²⁶³ Gazprom Rasschityvaet Stat Aktsionerom Gazotransportnoy Systemy Kazakhstana. Newspaper Kazakhstan Today, 05 July 2004

meaning in perspective Central Asian energy development. **China** is of primary attention, as far as the given question is concerned. Taking geographic propinquity to the region, it does hide its growing interests to participate in regional energy trends in Central Asia. Although China's influence is so far limited here in comparison with other major players, some purposeful and far reaching attempts to reinforce its position could be observed during the last years.

The two important factors stipulate such moves in Chinese foreign policy towards the region:

- domestic development
- geopolitical concerns.

Recent Chinese economic performance could not have impressing. In 2003 its GDP reached US \$1,4 trln. ranking the country's economic potential as the sixth largest in the world. After more than doubling in size in 1990s, China's economy is expected to double again in the coming decade and will have quadrupled by 2020. The latest economic development is taking place at the background of the reinforcement of chemical and heavy industries, broadened urbanization, increased demand for cars, trucks and other industrial means causing significant increase in domestic energy consumption. In 2003, share of oil and gas in total energy consumption structure reached 21,9% and according to forecasts, inputs are going to come up to over 40% by 2010. Industrial power consumption – 70% of the total energy consumption – has grown by 10% in 2001. Household consumption also faces growth between 10% and 14% per annum. It is conservatively estimated that the rate of urbanization will rise from the current 30% to at least 40% of the country's 1,3 bln.people. More than 520 mln.people will live in densely populated cities, mainly on the east coast, requiring electricity, transport, and heating.²⁶⁴

Despite being the world's fifth largest oil producer, the country has been steadily increasing oil import since 1993 (Table 4.4.). In 2003 Chinese oil import exceeded 91 mln.tons representing 40% of its total oil consumption. There are some estimates which suggest the volumes are expected to increase further making the country significantly dependent on foreign energy resources at around of 80% by 2030.²⁶⁵ In addition, China will need to import

²⁶⁴ Shiu D. Kitay: Neft I Politika. www.continent.kz, No 12 (124) 23 June-6 July 2004; Lelyveld M. China Seeks Oil Investment with an Eye on Pipeline, www.times.kg, 12 March 2003

²⁶⁵ The same.

about 21 mln.tons of gas in order to sustain the planned economic growth rates. It means that China's dependency on gas imports may finally run up to 40%.²⁶⁶

Table 4.4. Dependency on the Imported Oil in China

	1995	1997	2000	2002	2003	2004*	2010*	2020*
Domestic consumption, mln.t	161	197	200	210	227	280	350	500
Import, mln.t	37	68	66	76	91	110	150	300
Dependency on oil imports, %	6,5	18,3	27	30	34,5	37	46	60

* forecast

Sources: Compiled from data of ADB, IEA, „China sucht Erdölversorgungs-Sicherheit/Aufbau einer strategischen Reserve“, "Neue Zuercher Zeitung", 16 August 2004; Zheng L. "Polygeneration Based on Coal Gasification: A Strategic Technology for China" Report

Given that the per capita reserves of China are very low, especially on oil and gas, one may suggest that the future of the country will be significantly determined by its efforts to address national energy needs. In addition, China expresses its geopolitical concerns about political events on international arena since September 11 attacks on the USA. As a result, the latter has proved to be close not only to China itself, but to the places of Chinese oil import origin. Currently, the structure of oil import barely reflects national interests, given that 56% of oil comes out from unstable Middle East, 14% - from Asia and Asia Pacific, 23,5% - Africa and 6,5% - others.²⁶⁷ For this reason, China has decided to pursue a comprehensive strategy on the search for new sources of energy across the globe both to diversify the list of energy suppliers to China and find out the most secure routes for its transportation. The fact that China conducts exploration and development activities in 24 countries worldwide may only confirm how seriously these issues are concerned on the highest level, subsequently getting its plans materialized if they are really going to fit the Chinese interests.

A decade ago China laid the ground to the establishment of the "Shanghai Forum" group of nations embracing Central Asia's republics plus Russia. Among security concerns, economic and energy priorities are of specific interest too. From this point of view, China made its initial steps towards energy resources in "newly discovered" Central Asia by buying 60% of stakes in two oil fields in Kazakhstan – Aktobemunaygaz (100 mln.tons) and Uzenmunaygaz (140 mln.tons) in 1997 with total investment commitments at US \$9,5 bln. The China

²⁶⁶ Chan J. China Pushes into Central Asia for Oil and Gas. 03.01.2001; Zheng L. "Polygeneration Based on Coal Gasification: A Strategic Technology for China, <http://www.nrcce.wvu.edu/conferences/2004/China/presentations/lizheng.pdf>

²⁶⁷ Shiu D. Kitay: Neft i Politika. www.continent.kz, No 12 (124) 23 June-6 July 2004

National Petroleum Corporation (CNPC) outbid US and Western companies which allowed China to contract a 3000 km pipeline to Western China, as well as to use Iranian refinery facilities for further export to China in the future²⁶⁸ (map in Annex 4.3). Recently China and Kazakhstan have agreed and begun construction works on a 998-km oil pipeline Atasu-Alashankou to bring Kazakh oil to Western China not crossing the Russian territory. The plans are to deliver 10 mln.tons of oil at the first stage, with the gradual increase up to 50 mln.tons annually in the future with first supplies expected to be already in 2006.²⁶⁹

China also negotiates a more than 3000-km gas pipeline from Turkmenistan, Uzbekistan, and Kazakhstan to Xinjiang. Yet, due to high capital costs (about US \$10-12 bln.) and complex natural-geographic conditions, as well as the current shortage of funds to finance the project, its realization has been postponed so far. But China is prepared to continue its energy presence in the region, because it perceives that oil and gas pipelines from Central Asia to China could be extended in a way, so that to join the pipelines of Russia and Iran as well. This model has been dubbed the “Pan Asian Global Energy Bridge” – a Eurasian network of pipelines linking energy resources in the Middle East, Central Asia and Russia to Pacific coast through China. Then, the pipeline could be extended to Korea and Japan for another 1000 km which are traditionally net importers of energy resources. For example, according to some estimates, Japan’s gas needs will double by 2010, so will its total energy needs.²⁷⁰

Thus, China’s look at the Central Asian direction approaches a cautious, but purposeful expansion refusing short-run benefits in favor of long-term outcome. China relies upon perception that the method of pressure and rush attempts to acquire trust and will of the region may bring little. Through the persistent expansion of its influence on its small neighbors by virtue of economic and energy linkages, China is expected to further address its national and geopolitical priorities.

Iran

Another influential power, **Iran**, avails itself to get profit from underdeveloped transport and pipeline system of Central Asia too. Its interests are briefly to promote itself as a transit country for the Caspian and Central Asian oil to the Gulf and establish close political and economic ties with the region. Iran has sought to develop close relations with Turkmenistan. For Iran, Turkmenistan represents the bridgehead to Central Asia for trade and political links.

²⁶⁸ Beng P.K. Oil Needs Drive China West, www.atimes.com, 20 November 2002

²⁶⁹ Braun T. Territoriya dlya Drakona, ili Alyans dlya Dvoih, Newspaper Kazakhstanskaya Pravda, 12 March 2004.

²⁷⁰ Vieying Gas and Oil in Central Asia. 6 April 1997. www.chinainformed.com

Turkmenistan shares a long border with Iran, and there is already a gas pipeline linking it to the northern part of Iran, where most industries of Iran are located. Moreover, it could eventually transit Kazakh and Uzbek oil and gas to Iran. Iran itself has very large gas and oil reserves, but they are predominantly in the south, close to the Persian Gulf. From economic point of view, this cooperation between the regional countries and Iran is beneficial to both sides. For Turkmenistan, for instance, it opens an alternative to export its gas to Iran, for Kazakhstan – its oil, which may go much further to Persian Gulf and Indian Ocean, and then, further towards world markets. For Iran, it goes much beyond today's economic benefits, shaping far-going geoeconomic and geopolitical implications. First, Iran has a desperate need for foreign exchange and would benefit from oil and gas transit fees. Second, with oil and gas transit, Iran would be in a better position to develop trade with the region. Central Asia could eventually become an important market for Iranian manufactured goods. Third, Iran is in advantage to provide its northern regions with Turkmen gas and Kazakh oil, while southern fields would work for export through seaways or towards west through oil and gas pipelines to Turkey and then, Europe (see the map). In such a way, Iran would strengthen its position in the Gulf, essentially in relation to Saudi Arabia, potentially also in relation to other oil contenders. Emerging as a Central Asian power would also reinforce Iran's position in relation to the Gulf neighbors. In turn the combination of oil and gas transit and trade could establish Iran as regional power in Central Asia.

Iran pursues purposeful policy to suggest favorable transit deals and trade in the region by offering the least costly world market access for Central Asian crude. Recently Iranian vice-minister for transport and communications made it clear that further import of Central Asian energy resources on a swap-deal basis would make other alternative export routes unprofitable pointing at the US-supported route through Turkey.²⁷¹ In this regard, President of Kazakhstan N.Nazarbaev also emphasized that the southern route through Iran was the most attractive for both Kazakhstan and even American companies involved into Kazakhstan's energy projects.²⁷² The National Kazakhstani Oil and Gas Company "KazMunayGas" and "Kaznafta" company plan to build two oil reloading terminals in Iran with a volume totaling 150,000 tons. These terminals are expected to export annually 1.5 million metric tons of Kazakhstani oil to Persian gulf countries in addition to the current 1 mln.t.²⁷³ A pipeline from Turkmenistan has also been already built by Iran. In 2002 Turkmenistan supplied about 5

²⁷¹ The main reason for that is that Iran claims US \$20-22 for each ton transitted, with further potential to reduce transit fees up to US \$16. In comparison, the planned transit cost of the route via Turkey is expected to be not less than US \$32. Voropayeva L. Nichego Lichnogo. Newspaper Gazeta SNG, 02 June 2004.

²⁷² Voropayeva L. Nichego Svoyego. Gazeta SNG, 02 June 2004

²⁷³ The Kazakhstan News, 29 June 2004. <http://www.kazakhstaninvestment.com/kz-news-06-29-04.html>

bln.m³ to Iran, though its throughput capacity was brought to 12 bln.m³.²⁷⁴ In turn, Iran is ambitiously contemplating the possibility to increase swap oil supplies from the Caspian region through investments into modernization of existing and building up additional domestic pipelines which may increase volumes of oil transactions from current 8 mln.t to almost 25 mln.t annually by 2010.²⁷⁵

On the other hand, Iran itself behaves as a strong competitor in regional energy projects not only in terms of the Caspian energy reserves, but also tapping the markets of large energy consumers, such as China and India, for example. Iran suggested to build a pipeline bringing Iranian gas to India through Pakistan. It might have also affected the Pakistan's decision to suspend its talks within the Transafghan gas project with reference to the necessity of reserve assessment in the Turkmen gas field, despite several meetings at the highest level between Turkmenistan, Afghanistan and Pakistan have been already held, as well as project's feasibility study has been also launched by the ADB. Against the background of warming-up in bilateral relations between India and Pakistan, it is Iran who succeeds in pushing its gas project to the huge Indian market, rather than the Transafghan pipeline dated back to the early 1990s.²⁷⁶

Hence by choosing an Iranian outlet, as opposed to any other routes, the Central Asian oil exporters could thus keep more of the economic rent. Turkmenistan and Kazakhstan has evidently realized it when making so far insignificant swap deals with Iran. For Central Asia, Iran also represents the outlet that is the most secure from outside interference and pressure. Yet it certainly enhances Iran's position as a hub of energy supplies from the Persian Gulf.

The EU

In the last decade, **the EU's involvement** has remained comparatively moderate, at least with regard to the determination and pursuance of its clear priorities in the Central Asian region. Some experts relate this fact to the emphasis on the solution of intra-European problems, such the war in Yugoslavia, socio-economic issues in Europe, etc.²⁷⁷ On the other hand, the process of regionalisation and formation of the common European identity is still underway which makes it at least not simple to bring together the diversity of views under a common foreign policy which may allow the EU be actively involved in international politics and sustain its

²⁷⁴ Ashirova G. The Friendly Tandem. www.times.kg, 20 March 2003

²⁷⁵ Voropayeva L. Nichego Svoyego. Gazeta SNG, 02 June 2004

²⁷⁶ Some experts believe that Transafghan pipeline could only be efficient if it reaches Indian market. Pakistan, in its turn, is awaiting US \$400 tranzit fees annually from participation in the project proposed by Iran. www.gundogar.org, 11 November 2004

²⁷⁷ Moldaliev O. „Borba za Vliyanie v Tsentralnoy Azii“. In “Interesy ES, KNR, Rossii i SShA v Tsentralnoy Azii”. Round Table Materials, Bishkek, 2004, p.28

positions in different parts of the world.²⁷⁸ Attention to Central Asia was confined to the active development of bilateral contacts of some European countries, such as Germany, with the region, against the background of little interests from the others. Even financial investments into the most competitive mineral and energy projects from European companies were largely exceeded by the injections from US and Chinese corporations. It was partly a reflection of poor coordination of EU member-countries to form adequate external energy relations on the supranational European level, although quite the contrary seems to be required in terms of the importance of energy security for Europe.²⁷⁹ Therefore, in the past, Europe concentrated its policy mainly on technical assistance within TACIS, infrastructure development through TEMPUS (education) and INOGATE (energy routes) programs.²⁸⁰

Since 2000, the EU has been attempting to expand the areas of its involvement. The Central Asian states concluded Partnership and Cooperation Agreements (PCA) on a bilateral basis with the EU within which the latter had pledged to provide necessary technical and financial assistance to the states in the fields of administrative and institutional reforms, trade and investment, and democratic transformation.²⁸¹ It was in line with the new EU's security strategy which has experienced significant changes since the war in the Balkans. Its main implications meant that this approach might serve as a useful pattern for the handling similar explosive conflicts in other parts of the world,²⁸² or going even further and broadening the opportunities for the prevention of other security threats in the face of international terrorism, narcotraffic and export of weapons.

At the same time, the EU's interests in Central Asia should be considered through the prism of its energy strategy which is an integral part of common European security policy.²⁸³ Europe

²⁷⁸ Abdurazakov A. „Vozrastayushiy Interesy ES, KNR, Rossii i SShA v Tsentralnoy Azii“. In “Interesy ES, KNR, Rossii i SShA v Tsentralnoy Azii”. Round Table Materials, Bishkek, 2004, p.56.

²⁷⁹ Westphal K. “Central Asia and the Security of European Energy Supply”. In Seidelman R., Giese E. (eds.) Cooperation and Conflict Management in Central Asia, Zentrum fuer Internationale and Umweltforschungspolitik. Justug Liebig Universitaet, Frankfurt-am-Main, Peter Lang Verlag, Band 10, 2004. p.218

²⁸⁰ EC assistance totalling € 944,4 million has been provided to the countries of Central Asia over the past 10 years. Bilateral Tacis technical assistance, accounting for € 366,3 million. According to Regional Strategy Paper 2002-2006 & Indicative Programme for Central Asia, another 50 mln.euros of annual allocation are further foreseen. The strategy paper available at http://www.europa.eu.int/comm/external_relations/ceeca/rsp2/index.htm

²⁸¹ The PCAs are in force with Kazakhstan, Kyrgyzstan and Uzbekistan and signed with Turkmenistan, as well as the Trade and Cooperation Agreement (TCA) with Tajikistan.

²⁸² Tsakoloyanis P. The European Union and Regional Stability. The Case of the Balkans. In Seidelman R., Giese E. (eds.) Cooperation and Conflict Management in Central Asia, Zentrum fuer Internationale and Umweltforschungspolitik. Justug Liebig Universitaet, Frankfurt-am-Main, Peter Lang Verlag, Band 10, 2004. p.12

²⁸³ Given the mounting energy dependence, the European security strategy developed under the leadership of the EU High Representative X.Solana and adopted on 12 December, 2003, sets out the given issue among the primary concerns for the EU in the future. Thus common security in general and energy security in particular will subsequently necessitate the reinforcement of the European Foreign and Security policies in tackling global

is poor in energy resources whose regional production is going to go down in the future giving thus the way to the steadily increasing consumption of imported energy resources, especially natural gas. According to some long-term forecasts, given the EU's enlargement to the East in 2004, now every 2,4% annual economic growth will cause 1,8% rise of energy import bringing import dependency to almost 70% by 2030. While share of oil is expected to remain stable providing one third of total energy consumption, the share of natural gas is to increase by 67% (from 23% in 2000 up to 32% by 2030). It means that Europe will continue to consume even higher volumes of imported gas by 2030 facing 65% increase comparing to 2000. In its turn, share of domestic production is expected to decline by about 32 percentage points during the period considered (See Tables 4.5. and 4.6.).

Table 4.5. Structure of EU-25 Energy Consumption by Fuel

	2000		2030		Increment (2000-2030)	
	Mtoe	%	Mtoe	%	Mtoe	%
Solids	303	18	296	15	-7	-2
Oil	634	38	685	35	51	8
Natural Gas	376	23	630	32	254	67
Nuclear	238	14	185	9	-53	-22
Renewables	98	6	170	9	73	75
Gross Energy	1650	100	1968	100	318	19

Table 4.6. Prospects for EU-25 Natural Gas

Billion m ³ per year	2000		2010	2020	2030		Increment (2000-2030)
Imports	209	49%	352	506	576	81%	367
Production	221	51%	221	166	132	19%	-89
Total use	423	100%	573	672	708	100%	285
Gas in electricity	126	31%	209	274	287	43%	161
Gas in final energy	277	69%	336	365	383	57%	107

Mtoe – millions of ton equivalent

Source: Capros P. European Union – 25 Members Energy and Transport Trends to 2030.

Currently oil imported to Europe originates to 34% from the former Soviet republics with the major part coming from Russia; 20% - from Norway and 15% from Great Britain. Smaller amounts are imported from Libya, Syria, Saudi Arabia, and other countries. The main gas

exporters to Europe are: Russia (43,9%), Norway (27,7%) and Algeria (27,3%).²⁸⁴ Against the background of the regional energy import patterns, large single European countries, such as Germany, still continue highly concentrating Russia as the major energy supplier.²⁸⁵ In addition, some forecasts say that beyond 2010 North Sea and EU production will not expand. Gas consumption will require supply of about 18 bln.m³ by 2030, 10 bln.m³ are expected to come from Russia, Middle East and North Africa, with only 2,5 bln.m³ from North Sea and the rest 5 bln.m³ from intra-regional production.²⁸⁶

In the given context, it becomes vital for the EU to actively work over three intertwined issues in the realization of its energy security strategy. They are: diversification of its energy consumption structure; diversification of energy supplies by its origin; and expansion and improvement of transport routes to secure sustainable energy imports. For the EU Central Asia may represent a particular energy interest by its untapped and still undeveloped resource potential on the one hand, and huge political and economic potential of Europe itself on the other hand which is so far underrepresented in this region. European multinationals possess significant financial resources in order to realize the projects on diversification and improvement of export infrastructure of Central Asia and let it access on an attractive and integrated European market of goods, services and energy. Politically the EU has rich experience of common rules, fruitful economic relations, international laws and norms, concerning both the establishment of a common economic area and sustainable regional energy market in particular. Both are crucial in promoting stable development in the region.

Turkey

Taken into consideration the strategic EU-oriented priorities on the one hand, **Turkey** seeks the opportunities to play an important role in Central Asia by virtue of economic, political, social, historical and cultural instruments, on the other hand. Its interests are political and economic ties with Central Asia, as well as transit revenues and access to oil and gas.

²⁸⁴ Westphal K. "Central Asia and the Security of European Energy Supply". In Seidelman R., Giese E. (eds.) Cooperation and Conflict Management in Central Asia, Zentrum fuer Internationale and Umweltforschungspolitik. Justug Liebig Universitaet, Frankfurt-am-Main, Peter Lang Verlag, Band 10, 2004. pp.216-217.

²⁸⁵ The EU and Russia kickstarted an energy dialogue to resolve specific bilateral problems. The establishment of a kind of "constructive interdependence" through predictable trade rules, improved networks and encouragement of investments by promoting a more stable and transparent legal framework, as well as key reforms in the Russian energy sector is believed to help improve the EU's energy supply security in the short, medium and long term. See: The Energy Dialogue between the European Union and the Russian Federation between 2000 and 2004. Communication from The Commission to the Council and the European Parliament. Brussels, 13.12.2004; on-line version is available at the European Commission's web-site: <http://europa.eu.int/>.

²⁸⁶ Capros P. "European Union – 25 Members Energy and Transport Trends to 2030". Presentation on PRIMES and ACE Mathematical Models. On-line version is at: http://europa.eu.int/comm/energy/russia/events/doc/2003_presentation_energy_transport_trends_2030.pdf

The nomination of Turkey to counterbalance the potential expansion of neighboring Iran and, to some extent, to neutralize the Russia's influence on the region was supported by the USA. A major pre-occupation for Turkey itself is to reduce dependency upon the Arab Middle Eastern oil. Its energy priorities could be characterized as multi-edged directed not only to meet quickly rising energy needs of a large and expanding domestic market by possible supplies from Central Asia, but secure some political benefits too. The following tasks are brought forward by the government: provide diversified, reliable and cost-effective supply issues; liberalization of the energy sector; and become a major consumer and transit territory in the region.

According to some estimates, Turkey's energy demand is growing up to 8% annually which should provide energy consumption increase from 82,2 mln.tons of oil equivalent (toe) in 2000 to 179 mln.toe by 2010; for natural gas – up to 55 bln.m³ by 2010 and 83 bln.m³ by 2020.²⁸⁷ Turkey lobbies East-West energy projects, consisting of the Baku-Tbilisi-Ceyhan crude oil pipeline, the Southern Caucasian Natural Gas pipeline (Baku-Tbilisi-Erzurum), and Turkmenistan-Turkey-Europe gas pipeline projects.²⁸⁸ These projects, according to Turkey, would allow both balanced domestic consumption and transit some energy resources to other parts of Europe. Thus it would also be in line with the Green paper “Working Towards a European Strategy for the Security of Energy Supply”,²⁸⁹ as a fourth largest source of energy to Europe. On the eve of potential accession of Turkey to the EU, Turkey is interested to use energy sphere as another area of close cooperation with the EU.

The most ambitious oil project with Turkey's involvement is the Baku-Tbilisi-Ceyhan pipeline which is built under the immediate US-led policies and implemented by a consortium of European energy multinationals. Being launched in September 2002, an almost 1800 km long pipeline is expected to be completed in 2005 with \$2.93 bln. of construction costs and

²⁸⁷ Mekhmud Q. Turkey's Energy Politics in the Context of Eurasian Geopolitics. Event Report, July 2002. See on-line version at www.bcsia.usg.harvard.edu. See also Kilic A. Turkey and European Energy Security, *Wirtschaftsforum Nah und Mittelost*, Marz-April 2003, No 2, on-line version at: <http://www.nah-undmittelost.de/wf22003.pdf>

²⁸⁸ Since 30 March 2000 Turkey is a signatory to an Umbrella Agreement of INOGATE programme which foresees the transportation of natural gas produced in the Caspian, Middle East and South Mediterranean countries to Greece via Turkey. By 2020 Turkey thus plans to become a huge natural gas transporter from the Caspian and Middle East Region to Europe. See more on the web site of Turkish Petroleum Corporation BOTAS at <http://www.botas.gov.tr/eng/about.asp>

²⁸⁹ Adopted by the European Commission on November 29, 2000, the Paper stated that the most appropriate strategy to ensure stable energy supply was to diversify energy sources and origins of supply, and supported the increase in political and economic cooperation with the Caspian Basin countries to obtain a more geographically distributed energy supply. In other words, while some countries (Russia, Algeria and Norway) were expected to remain the main gas suppliers to Europe, a number of new gas suppliers to Europe, mainly Azerbaijan, Iraq, Iran, Egypt, Libya, Trinidad and Qatar were welcomed. Available at the European Commission's site at http://europa.eu.int/comm/energy/index_en.html

another \$600 mln. in linefill and loan interest during construction.²⁹⁰ However, the project is likely to be confronted with a number of issues in order to become sustainable and economically more viable.²⁹¹ The latter stems from hopes to see Kazakhstan's involvement as an important oil supplier, though Kazakhstan does not seem yet to show its ultimate commitment in view of other alternatives with China and Iran. Moreover, Russia neglects any route through Turkey which would weaken its own position. On the contrary, Russia itself is a large supplier of natural gas to Turkey through the Blue Stream pipeline built and put into operation a couple of years ago. Moreover, there are plans of Iranian gas supplies which may give Turkey to use its transit status towards Europe and for Iran – another export option.

At the same time, a number of factors are serious setbacks to the full realization of Turkey's interests in Central Asia. Turkey's variant of Central Asian oil export is both costly and politically vulnerable compared to the alternatives suggested by Iran, for instance. Turkey will barely compromise Russia's interests in the region, since it has close economic, trade and energy relations with Russia. As it has become clear from the past experience, common historical, religious and linguistic values are insufficient elements for ambitious Turkey's dominance in the regional processes. Finally, domestic situation, related to security of the transit pipelines through Turkey may only exacerbate the energy projects put up by the country on the regional level.

4.4.2. Geopolitical Implications

The Central Asian energy discourses should be considered not only in the light of immediate interests of major players towards the regional states, but also through the prism of their policy strategies towards each other. The issue is whether the energy-related activities will remain an aspect of contention between the major players, or on the contrary will promote some changes in foreign policy doctrines towards tolerance and better coordination.

In taking sometimes even open forms, the rivalry, mainly between the USA, Russia, China, Iran and the EU over the construction of future pipelines out of the region would mean that

²⁹⁰ The scale of activities by both the parties involved and documents prepared are impressive. The financing package included 208 finance documents, with over 17,000 signatures from 78 different parties, with more than 12,000 people employed along its entire route from Baku to Ceyhan (Turkey). See: Baku-Tbilisi-Ceyhan Pipeline - BTC Gets Funded, Azerbaijan International, Spring 2004, on-line version at http://www.azer.com/aiweb/categories/magazine/ai121_folder/121_articles/121_bp.html

²⁹¹ Although with a half of construction works already finished, the project is still facing additional difficulties, including organizational (resistance from displaced people, land expropriation mechanism), environmental concerns, corruption, as well as security concerns. See more: The Baku-Tbilisi-Ceyhan Pipeline - Oil Wealth for whom? http://www.bankwatch.org/publications/issue_papers/2004/ebrdagm/btc.htm; Baku-Tbilisi-Ceyhan pipeline: not yet finished and already threatened, <http://www.iags.org/n1104041.htm>

each of the states will follow its strategic priority interests in the given region. The USA, like the EU, is a newcomer to the region and simultaneously an outsider. The US policy towards the regional resources will be obviously based on universal ambitions. As the world's leading oil importer harboring the major part of the world's oil industry, the US has a persistent interest in a stake in and preferably a control of the major global energy provinces, wherever they are. At the same time, it has to face a difficult task not to allow any contenders to make its presence dominant in Central Asia. So far, the U.S. policy has been to avoid any understanding between the region's oil and gas exporters and Iran, to prevent the latter from serving as a transit point. Since the end of the Cold War the United States has viewed Iran as one of the major adversaries. By accepting of a transit route through Iran, the United States would not only recognize Iran as a major power in international oil politics, in the Gulf and in Central Asia, but also renounce on its ambition to get the Central Asian energy to the Mediterranean. Hence the position of the Gulf in the world oil market would be reinforced, also strengthening the supply and price risk. To sum up, for oil supplies and prices the United States would face an even more significant Gulf, but with a stronger Iran.

On the other hand, economic boost in China and its rising political credibility across the whole region is another concern for the USA on the way to its efforts to limit Chinese involvement. More than 55% of American academicians and policy-makers believe that China is a potential threat to American national interests.²⁹² From this viewpoint, the USA tries to minimize any involvement of China in oil tenders in Saudi Arabia and Iran, in post-war reconstruction of Irak, as well as directly in Central Asia by impeding the process of construction of oil pipeline from Western Kazakhstan to China.²⁹³

Therefore, the USA is going to face a dilemma to isolate Central Asian energy from Iran and minimize Chinese expansion on the one hand, but comply with some of Russia's interests if needed, on the other hand, which would mean a recognition of a more resourceful and more self-confident Russia.²⁹⁴ Since the pipeline projects through the Afghanistan's territory are at least the plans of an indefinite long-run period, Russia could be perceived as more acceptable variant in comparison with Iran and China. Before the events of September 11, what liked Russia, usually did not like to the USA. Against the background of common Russian-American interests and reciprocal relations between these two countries during the last

²⁹² Bondarets L. Voenno-Politicheskie Aspekty Interesov Vedushih Derjav Mira v Tsentralnoy Azii. In "Interesy ES, KNR, Rossii i SShA v Tsentralnoy Azii". Round Table Materials, Bishkek, 2004, p.107.

²⁹³ Shiu D. Kitay: Neft i Politika. www.continent.kz, No 12 (124) 23 June-6 July 2004

²⁹⁴ Oystein Noreng, Oil in the Caspian Region and Central Asia the Political Risk of the Great Game Continued. Contribution at a conference held in Boulder, USA, April 11th. 1998. <http://www.caucasus.dk/publication8.htm>

decade, their views on Central Asian energy resources were sooner developing in competitive manner, rather than on the basis of friendship and cooperation. *“Geostrategic implications for the US are clear: America is too far, so that to dominate this part of Eurasia, but it is too mighty, not to get involved... Russia is too weak to revive its own imperial domination in the region, or to exclude such domination coming from other states. But it is too close and strong to exclude her at all”*, wrote Zb.Brzezinski.²⁹⁵

Yet, currently Russia is becoming a great energy producer and exporter being independent from the OPEC. The USA seems to see in Russia another significant source for its energy import. Russia recently agreed to support calls of the American administration to increase oil and export of oil regardless of world prices. After the meeting with US Energy Secretary Spencer Abraham, Russian Prime-Minister M.Fradkov confirmed that Russia was interested in gaining a 10-12% share of the US crude oil market which makes Russia a logical strategic partner to the USA.²⁹⁶

The interest of the United States is also apparently to get the Central Asian oil to the Mediterranean or to the Indian Ocean. The reason seems to put a downward pressure on Atlantic crude prices, partly to reduce the overall supply and price risk in the world oil market due to the dependency on the Gulf. The U.S. is also eager to provide assistance to Turkey economically by getting transit revenues. Baku (Azerbaijan)-Tbilisi (Georgia)-Ceyhan (Turkey) oil pipeline is thus more politically motivated rather than a reflection of an economically efficient route to bring Caspian and Central Asian energy to world markets avoiding the Russia's territory. On the contrary, the Transafghan gas and oil pipelines from Turkmenistan to Pakistani seaports through Afghanistan are more economically viable covering 1500 km with capital costs at approximately \$2,5 bln. First attempts were made as early as 1994. There was even an agreement between the governments of four countries, Turkmenistan, Afghanistan Pakistan and Uzbekistan. However, the unstable situation in Afghanistan postponed the project. In this respect, the U.S. oil companies in the region, such as Chevron and Unocal, also political actors, with an increasingly important role in the region, are still willing to renew the project, once the political situation in Afghanistan has stabilized.

The advantage of Russia in comparison with others is in its strong cultural and historical influence on the countries reinforced by the strengthened economic relations within the recent years. Central Asia, like other areas of the former Soviet Union, is still bound to Russia in

²⁹⁵ Tsentralnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost. Group of authors (2002), Tashkent. p.89. Quotation from Brzezinski Zb. The Grand Chessboard.American Primacy and its Geostrategic Imperatives (Basic Books –Harper Collins Publishers, Inc, 1997).

²⁹⁶ Blagov S. Russia: Yet Another Central Asian State. www.atimes.com, 03 June 2004

many ways. Spare parts for a number of machines being used across the territory still come from Russia. Other connections remain as well. In addition, many might not consider Central Asia the best place to invest part of this newfound wealth. But for Russian investors and the Russian government, the region is actually well-positioned for investment. Where Russia might try to expand its economic relations overseas, there aren't that many markets, for example, where really Russia can be competitive. It happens that in Central Asia there is something of a natural market, a natural basis for economic relations between these countries. It's relatively cheap to buy up assets in a place like Tajikistan or Kyrgyzstan, for example. Russian companies know the region and speak the language of the people they are dealing with. That's the big advantage of Russia before Western companies operating in the region.²⁹⁷

Russia is ready to cooperate with other major players, regardless of the USA, China, Iran or the EU provided that the latter should recognize Russian interests in Central Asia and therefore, coordinate their policies with Russia. Russia has good relations with Iran in many energy-related activities, including construction and maintenance of the scientific nuclear facilities, development and exploration of energy base in Iran, etc. Besides Russia and Iran are the most concerned parties in the transport corridor “North-South” across the Central Asian region.²⁹⁸

In its turn, Iran is emerging as an independent player trying to keep up friendly contacts with all its neighbors and a constructive dialogue with the EU on energy issue and in economic and political fields which could help it offset the US sanctions on investments into Iran. Iran attempts to maintain good relations with its northern neighbour Russia also because of the unresolved problem of the Caspian status whose positions are quite different. China and Iran cooperate in political and military area, as the Chinese arms supply are a major concern and reason for the US warnings.²⁹⁹ In its turn, given Iran possesses one of the largest energy reserves in the world, China expresses its growing interests in the development and exploitation works there which finds appropriate countenance in Iran. Recently the both countries signed a Memorandum envisaging a special provision to favor the development by Chinese companies of one of the largest domestic gas reserves, without preliminary tender arrangements with other contesting companies from Europe and Japan.³⁰⁰

²⁹⁷ Pannier B. Russia Comes on Strong in Central Asia. www.atimes.com, 19 November 2004

²⁹⁸ Bondarets L. Voenno-Politicheskie Aspekty Interesov Vedushih Derjav Mira v Tsentralnoy Azii. In “Interesy ES, KNR, Rossii i SShA v Tsentralnoy Azii”. Round Table Materials, Bishkek, 2004, p.111.

²⁹⁹ Blagov S. Oil Needs Drive China West, www.atimes.com 20 November 2004

³⁰⁰ In particular, Chinese Sinopec Group is expected to get the legal right to develop the Yadaravan oil field provisioned that China would buy 10 mln.tons of oil annually for the next 25 years. See: Kitai Nachnyot

China is surely concerned by the fact that the USA is steadily becoming dominant in the areas where Chinese energy imports originates from. In this regard, China also sees in Russia a relatively acceptable long-term sustainable supplier of energy for its growing economy. During Russian President's official visit to China in October 2004, Gazprom and the China National Petroleum Corporation (CNPC) signed an agreement on a strategic partnership. According to the agreement, the two sides are to prepare for natural gas supplies from Russia to China. The agreement stipulates cooperation in oil and natural gas exploration, production, transportation and sale, gas-transporting and gas-distributing systems development, as well as underground gas storage construction and handling in China.

Moreover, Russia and China set a common goal for their bilateral trade to reach \$60 billion by 2010, which is 3 times higher than current volumes, presumably bearing in mind increasing Russian hydrocarbon supplies to China. Talks are also underway a 3,000-mile gas link from the Kovykta field in eastern Siberia, first proposed nearly a decade ago, and a 1,500-mile oil link from western Siberia to Daqing, the heart of China's refining industry.³⁰¹ But China fears that the strategy to import from Russia is, however, not entirely risk free. The one factor that constricts the ability of Russia to increase exports is infrastructure - namely, inadequate pipelines and port facilities. Since American firms possess the technological wherewithal and capital funding to assist Russia, the latter's export and piping routes will likely mirror the preferences of the United States. This puts China in an acute position as the two combined could potentially compromise its national interest. Although East Asian and domestic issues remain more important for China than any West Asian considerations, China cannot afford not to be more sensitive to events in the region in the future. China's position as a serious economic and political player at the world stage requires that it has a regular supply of oil, without which it could be easily held hostage.

Russia, in its turn, will not step aside from the Chinese efforts to catch some part of the Central Asian energy pie. Recently the Russian Minister of Energy and Industry expressed its hidden concern on bilateral actions between Kazakhstan and China to build export pipeline towards east. He said: *“Our prospects (i.e. those of Kazakhstan and Russia) on the exploration and routes of transportation should be made known and agreed on as early stages as possible. Then, we will avoid surprises on the one hand, and be prepared to any possible developments on the other hand”*. Although Russia was invited to take part in the project and

Dobychu Nefti v Irane, 01 November 2004; Iran Mojte Peredat Kitayu Razrabotku Neftyanogo Mestorojdeniya Yadaravan bez Tendara, 09 November 2004. press.lukoil.ru

³⁰¹ Blagov S. Russia Energizes Asian Conquest. www.atimes.com, 27 October 2004

fill in the pipeline once it has been built, Russia seems not to be in a hurry, probably in fear of undersupplying its own pipelines which face now a proficit of capacities. On the contrary, the Russian side raises the issue to expand throughput capacities of the Caspian Pipeline Consortium bringing oil to the West, not the East.³⁰²

Each of the players has its own imperatives in devising foreign policy which are going to reflect its strategic geopolitical priorities. If this continues, it surely will bring little to the regional states to free up their economies from the negative influences of poor infrastructure, land-lockedness, as well as the suboptimum development and use of its natural resource base. In addition, geopolitical contradictions may lead to a zero outcome, since none of the players has a full set of dominant and long-term advantages. It means that any pipeline project in Central Asia will face a great risk to be at best continuously postponed, both for economic and geopolitical reasons. In the worst case, Central Asia may encounter the danger of marginalization from the main foreign investment flows benefiting thus little from its abundant energy reserves.

It seems to be well perceived by the Central Asian states, since all of them are striving to combine “good neighborhood” with the regional powers, such as Russia, Iran and China, and simultaneously “strategic partnership and cooperation” with non-regional ones, such as the USA and EU, for instance. Another strategy of the major players towards the region would suggest that it is not going to be a zero-sum game, but compromised, result-oriented steps whose positive effects will cover both “regionals” and “non-regionals”. The Central Asian states badly need the political and security stability that will attract continuing investment in the development of its energy resources. The zero-sum notion that there is a certain amount of oil for the regional powers to fight over is dangerously shortsighted, particularly at a time when the world’s hunger for energy is growing so quickly, and ever more pipelines and export routes are needed to get supplies to market. There is more than sufficient market share across the globe to guarantee the region substantial national revenue. The latter is desperately needed for social and infrastructure projects of national and intra-regional scale which mainly remains a strategic task of the regional governments. What is needed is a dynamic, well-coordinated partnership that profits from local comparative advantages and economies of scale to get untapped energy resources to the markets that need them.

The United States, the European Union, China, Russia and Iran on the one side, and the Central Asian states on the other side should view the region as a single integrated energy

³⁰² Ivanenko I. Truboprovod v Kitay Ostavit “Transneft” bez Tranzita. Newspaper Kommersant, 11 November 2004

marketplace. Together they may begin a comprehensive “Eurasian energy dialogue” that would bring together the major outside investors—especially the United States and the European Union—with the region’s key actors. Joint projects that combine the experience, resources and technologies of Western, Asian and Russian firms can bring online energy deposits that would otherwise remain in the ground.³⁰³ Tension and rivalry between them over access to Central Asian energy could be eased by a more transparent and cooperative approach to the development of its energy resources being equal parts to this energy dialogue.

Any outcome for the West would be more palpable and durable insofar as Russia, China and eventually, Iran would be partners. Hence the issue of energy should be predominantly oriented to the search for the multiple ways to unlock Central Asian oil and gas and promote diversification of transportation routes making their effects felt throughout the long-term period. Finally, it is also in vital interests of the young regional states to somehow balance close relations with the West and the links with their great neighbors.

4.5. Summary

Cooperation on the regional level acquires a particular significance. Central Asia in general has a vast energy base which, however, is unevenly distributed throughout the region. The bulk of water and hydropower resources are concentrated in Kyrgyzstan and Tajikistan, while fossil fuel resources are mostly located in Kazakhstan, Turkmenistan and Uzbekistan. It allows to secure stable power supply to the domestic market on the one hand, and significant volumes of oil, natural gas and coal for export on the other hand.

But nowadays, energy industries of Central Asian countries has plunged into serious technological and economic difficulties. The wear and tear of machinery is extremely high. Ineffective pricing and tariffs policies with regard to energy, a drop in solvent demand and failure to pay for energy supply by domestic and foreign consumers impede the capacity to invest in the maintenance and development of fuel, generation and transport facilities that form the basis of the power industry.

There are two strategic goals in the energy field which may contribute to the sustainability of Central Asian development in the future: self-sufficiency of the region in energy resources; and development and diversification of pipeline network system, both inside and outside the region.

³⁰³ Bremmer I. and Hawes C. An Insatiable Thirst for Oil.
<http://www.inthenationalinterest.com/Articles/October2004/October2004Bremmer.html>

Equally energy efficiency and conservation policy are called to reduce energy intensity of Central Asian economies which exceeds several times that of leading industrial nations so far; minimize fuel and energy losses in all branches of economy promoting realization of substantial potential for energy savings which, if tapped, would greatly contribute to economic recovery and release significant investment resources for further development of mining and generating capacity, pipelines and networks, as well as to the easing-up of regional and global environmental pressures.

To make these goals viable, Central Asian countries are to attract large-scale investment into the energy complex assisting in the exploration and development of new fuel resources, the modernisation and construction of new power plants, construction of new pipelines and electricity transmission lines and maintenance of existing ones, as well as the implementation of energy conservation projects. In addition, appropriate tax and fiscal and price policies, legal framework, market reforms, and training of experts are also to be essential.

The regionalisation of Central Asia's energy markets has a bright future, if pursued properly, since the regional states are closely connected through existing regional energy network and trade in energy resources. Besides, there is still shortage of energy in some countries. Therefore cooperation of Central Asian countries in the sphere of energy would imply establishment of regional energy market, coordination in pursuing intra-regional and interregional energy policy, so that to maintain intra-regional energy security and efficiency of regional energy exports. It would be unwise and wasteful to restrict trade in energy resources to Central Asia already because its power production potential and vast resources exceed the requirements of its economy and population.

The main obstacle to further increase in exports of fuel and energy from the region is a poorly diversified network of pipelines bringing oil, gas and electric power from Central Asia to world and regional energy markets. At present, energy exports from Central Asia are mostly to go through Russia. A number of energy projects are at different stages of development, with the support from foreign multinationals, as well as governments and financial institutions (summarized in Annex 4.4). Foreign investment in the Central Asian energy industries can only be welcomed. Obviously, as economic stabilization continues and investment laws get better, foreign investment may significantly increase.

Equally yet their realization will be largely dependent on how Central Asian states will manage to balance regional interests with the geopolitical and geoeconomic imperatives of the USA, Russia, the EU, Iran, China, Pakistan, Turkey. The USA driven by its universal

principles to push forward democratic values on the global level, are nevertheless trying to defend its geopolitical interests in the whole Eurasian continent, together with Russia, China and Iran. Russia has been showing very active engagement into regional economic and political processes in the last couple of years, striving for the restoration of its weakened positions in the past. China is concerned in both finding as much as possible diversified energy sources outside China for its rising economy, and pursuing active cooperation with major powers in the region (Russia, Iran, India) to strengthen its credibility and influence. Iran attempts to benefit from its advantageous geographical location by bringing forward economically viable energy and transport routes for Central Asian energy exports. The EU is gradually increasing its presence in the region enhanced by its future dependency of energy imports and security concerns over the potential global threats.

In general, there are probably a few main alternatives related to Central Asian energy developments in the future. The first one would imply that the launched hidden rivalry between the main players could continue. For Central Asia it gives little positive effects in terms of the necessity to solve its desperate energy infrastructure problems, the efficient use of resource and secure sustainable foreign exchange and investments into the regional economies. The second way would ideally suit for the regional interests, since it recommends not to consider Central Asia as a battle field, but regard it as a space to bring the main competitors together, since none of them currently has an advantage and potential to dominate there. It is better for them to share common experience, costs and technologies, with the region to see global energy supplies and prices more stable, as well as set up the pre-conditions for prosperous and sustainable development in the region. Finally there could be also some sort of the mix-up of the two previous scenarios, when some countries, such as the USA or China for example, could prefer closer cooperation with one countries, but again with the purpose to restrain a rising influence of the others.

Chapter V. INTEGRATION WITH THE WORLD ECONOMIC COMMUNITY

5.1. New Pillars of Foreign Trade Policy

In the Soviet period Central Asia was not represented in foreign economic activities in a full manner, being actually cut off from the rest of the world. The scope and depth of foreign relations were significantly limited, while what was eventually allowed was nevertheless remaining under the close Centre's spotlight.³⁰⁴ The foreign economic field was a state monopoly with the tough control from Moscow through organizational and institutional components, such as Soyuzvneshtorg (the Union Ministry for Foreign Trade), Vneshekonombank (the State Bank For Foreign Economic Relations, etc.)).³⁰⁵

The share of Uzbekistan in total foreign trade turnover was insignificant.³⁰⁶ With the perestroika to be launched in the mid-1980s, some ideas of liberalism came into the system of the centralized planning. The distribution of functions between Moscow and the Union's republics became the main subject of talks. Understanding of the shortages of the existing system forced the Union's government to hand over some of its functions in foreign trade to the republican authorities. Moreover, there was also a certain degree of awareness to launch some market mechanisms in domestic economy, such as free markets of goods and services, yet state monopoly on means of production was still supposed to remain.

This wave of liberalism also touched upon Uzbekistan. In 1989 the republican agency "Uzvneshtorg" was set up to deal with foreign trade issues. It was, however, soon reorganized into the State Committee on Foreign Economic Relations. Then, after the declaration of independence, the given Committee was changed into the Ministry of Foreign Economic Relations in 1992. Simultaneously, a number of other institutions in the frame of the system of foreign economic relations were also established, such as Customs, Insurance, Financial, etc. agencies. Foreign trade becomes one of the main fields of active government regulation. The retention of active government involvement at the initial stages of transition was

³⁰⁴ Basically, Uzbekistan was a host to a number of international cultural events with some sort of information and propagandist character, such as the Biennial International Film Festival of the countries of Asia, Africa and Latin America, in which only foreign countries from the Third world friendly to the USSR, took part regularly. Higher institutions for teaching and training specialists in orientalistics and language philology were also existing in the republic, still only a limited number of local staff in comparison with those who were able to graduate from the Moscow's universities in similar fields, could make proper diplomatic career in the Soviet embassies abroad. See also Inomjonov Kh. "Aussen und Sicherheitspolitik der Republik Usbekistan in den ersten Jahren der staatlichen Unabhaengigkeit" within the Central Asian project.

³⁰⁵ According to some estimates, more than 80% of export and foreign exchange were controlled by Moscow and Russia, with 2/3 of total gold sales and more than 65% of the whole Soviet imports. See: Hanson Ph. The Economies of the Former USSR: an Overview, in Eastern Europe and the CIS, Paris, OECD, 1999, p.81.

³⁰⁶ These figures amounted 4% for export and 4,8% for import in 1990. See: Annex 1.1b.

explained by lack of institutional base and expertise on the market system. With time going by, however, priorities within domestic strategy are obviously going to be shifted.

The foreign economic sector is not an exception. The key element in the new domestic strategy in the years to come is to be so called “optimization” of government policy in the light of liberalization of processes in the foreign economic sector. This “optimization” must be understood not only as the reinforcement of domestic economy and its long-term sustainable economic growth, but also as successful integration of Uzbekistan into the system of international relations which, in turn, is a complex process to require both time and additional efforts, and, therefore, prudent national strategy as well.

It is beyond the purpose that a transition economy which is trying to expand its foreign economic relations, should rely on exclusively market forces and mechanisms. Therefore, active government policy could play the role of a creator and coordinator in the domestic process, particularly at the outset of the reforms. In the long-run, however, there is a strong need for the appropriate adaptation of government policy and its tools to the permanent changes which take place both in domestic life and across the world.

Liberalization of foreign economic relations becomes a more crucial and necessary element of the reaction to these changes. On the one hand, liberalization implies more freedom and sovereignty to economic units included in the system of foreign relations; transition from the direct administrative methods of regulation towards indirect, market tools in government policies; and the hindrance of existing barriers and obstacles in foreign trade. In this particular case, this is an objective and integral part of domestic liberalization of economic and socio-political life, further structural and legal reforms in Uzbekistan. But on the other hand, it is a step forward to acknowledge the common rules and procedures widely extended in the civilized world community, the equal member of which Uzbekistan became after the 1990s.

The main forms of such liberalization, according to the world practice, could be the expansion of foreign investments into the country, the avoidance of centralized system in foreign economic relations, the elimination of protectionist barriers for imports, export promotion, and current account convertibility of national currency. The skillful combination of the given forms allows the country to integrate with the world community on a mutually advantageous basis, with the simultaneous irreversible actions towards market mechanisms, and minimizing potential threats and damages of the multi-edged process. Since this process could also be seen as some kind of input-output one, they suggest to apply these tools in order to pursue national domestic interests too. How effectively they can be used by the government is

significantly dependent not only on real domestic conditions, specific to any single country, but also on the government itself which is liable for implementing general strategy of national development.

At the same time, the strategy of long-run sustainable development of Uzbekistan requires to take appropriate measures towards the permanent improvements against the existing bottlenecks in the system of foreign economic relations. These challenges could be mainly set out as follows:

- the absence of a well-grounded scientific strategy in foreign economic relations, at least for the medium run;
- poor development of organizational infrastructure of foreign trade and export promotion strategy chosen by the government as the priority for sustainable development;
- insufficient market skills and knowledge among many economic units acting in the foreign field. This deficiency reflects in inefficiencies of their access to regional and world markets, low legal and technical experience both of which are integral part of foreign economic practice;
- lack of or a limited access to commercial information in world markets;
- the undeveloped system of technical assistance in key areas of foreign economic relations;
- the comparatively low level of coordination among state agencies, including those directly involved in foreign economic relations.

On the contrary, it is critical that all the tools may be equally significant and give no efficient results if they are secluded from each other and pursued without appropriate coordination with the other policy components. Moreover, existing problems may considerably weaken the efficiency of not only the programmes and steps in foreign economic area, but also affect those operating with primarily domestic issues. Actually, the reforms, either domestic or foreign, are strongly interrelated with some impact on each other in short- and long run. Therefore, Uzbekistan is in great need for comprehensive and well-grounded scientific foreign economic strategy, as well as for prudent technical assistance programmes conducive to the further development of foreign trade and joint entrepreneurship.

Some priority areas the national strategy should embrace, will concern the main components of foreign economic policy, including import and export policies, as well as the reforms in domestic legislation, the shifts and priorities in government policies, and the role of FDI in the frame of overall liberalization in the foreign economic sector.

5.1.1. Necessity for Import Policy Adjustment

One needs to emphasize that for a decade of independent development, Uzbekistan tried to follow consequent reforms in domestic trade regime in accordance with world's trade practices. In short, these steps could be characterized by the following characteristics and priorities, different in time and tools of their realization:

1991-1994 - with a relatively low level of import tariffs (5-10%), the restrictions were imposed on exports. Export licenses were required for 74 groups of goods and 40% customs tariffs on export was introduced. The main aim of the foreign trade policy at that time was to control the main flows of goods, services and financial capital in trade with other republics, in terms of high uncertainty and mistrust in the post-Soviet territory, instability of mutual monetary and payment relations, and actually transparent customs borders between the former Soviet republics.

1994-1995 - all import duties on consumer goods were lifted, in order to balance domestic demand and inflation. The number of goods which required export licenses was significantly reduced, from 74 to 4 positions in the end of 1995, however the level of tariffs continued to increase up to 50%, and in some cases - even up to 100%.

1996-1997 - the period of initial macroeconomic stabilization. At that time differentiating import tariffs (from 5 to 50%) were introduced, and export customs were preserved, though two times were steadily reduced during 1996, except for raw materials. The feature of that time is that foreign exchange restrictions were introduced in IV quarter of 1996.

1998-2004 - import customs and duties had been adjusted very often, especially in the recent years and reduced on average. However, they still remain high enough to serve as a serious barrier to imports. Export customs were fully eliminated.

More specifically, foreign trade development in Uzbekistan in the past may bear the following main implications (See Tables (a) and (b), Annex 5.1).

In the years of independence, foreign trade turnover has doubled from \$3,083 bln. in the 1990s to \$6,68 bln. in 2003. The main shifts in priorities are embraced by the structure of main imports to the republic in different years. By giving a look at the merchandise structure of the early 1990s, one may see, that almost half (46% in 1992) in the republic's imports was food products, which fell to less than 10% in 2003. The latter figure points at the shifts of priorities from import to local production of major food products to cushion the food problem and rationalize domestic policy in redefining the national borders for economic security. On

the contrary, the share of machines and equipment in total imports saw eightfold increase from 5,2% in 1994 to 44,4% in 2003 as a result of government priorities to modernize and establish new industries in the domestic economy. The share of energy and related products fell down from 13,3% to 2,7% for the given period, which also was ensured not only by the economic necessities of continuous supplies of energy to domestic industries, but by political reasons too: while being less dependent on the main outside suppliers from North (oil and fuel from Russia and Kazakhstan) and from South (gas supplies from Turkmenistan), the country's potential would allow to turn into one of the main regional energy exporter in the future. Finally, imports of services increased from 0,3% in 1994 to 10,2% in 2003, which was basically related to permanent growth of transit tariffs on Uzbek goods across the territories of the neighbor countries.

In more general way, the current scheme of national trade policy is made up of the following main elements³⁰⁷:

1. strategic or social goods, which are supposed to have no opportunities to be produced in the republic, as well as raw materials and intermediate goods for the needs of domestic economy, including export-oriented industries, are levied with the least import taxes;
2. the main group of imported consumer goods and other wares whose analogues are also produced domestically, are facing more protectionism;
3. the goods which have good perspective, such as high technological equipment, home appliances, food and textile industries, but ill-developed at present for objective reasons, are protected until they become competitive.

The government of Uzbekistan had eventually pledged to provide current account convertibility of national currency according to Article VIII of the Agreements of the IMF on October 15, 2003.³⁰⁸ The former, restrictive foreign exchange policy was consistent with the

³⁰⁷ Zarudnaya V. Tamojennye Stavki Umenshayutsya. No Voprosy Ostayutsya. www.zamon.info, 2004, march

³⁰⁸ It needs to be pointed out, however, that international commitments arisen from the Article VIII of the IMF Agreement, as well as the tough macroeconomic parameters defined in the specially concluded the Staff Monitored Programme, put the domestic policy-makers under a certain extent of pressure. The Government decided to follow step-by-step devaluation of national currency - sum, by determining as a starting point, relatively over-valued exchange rate for the sum, according to international experts. From the national point of view, one of the main grounds for choosing this strategy was a fragile situation with many Uzbek enterprises, which are working with commercial foreign borrowings. The fears that decisive devaluation could merely put them into severe pressure in terms of repayments on foreign debts apparently turned out to be a primary concern for the Government in this respect. However, such the strategy will require from the Government considerable foreign exchange funds to satisfy domestic needs in foreign exchange. In these particular terms, the Government took complimentary measures on restrictive monetary policies and on operations with cash in domestic consumer retail markets, with parallel high import duties, which severely restricted imports of small units and physical entities to the country. The latter step caused a great concern among multilateral donors and private sector as to be an obstacle on the way to favorable business environment, especially for small-scale

general trade regime. For that reason, liberalization of foreign exchange regime seems to have direct influence on tools and content of domestic trade policy and certainly requires appropriate adjustment in compliance with the changes which have been taking place. Moreover, with the intensification of integration with the world community, import policy in particular would require a clear steps on its further strategy in order to make the international commitments fully feasible. Political implications of this step are also important. Domestically this step can serve as an integral part of general intentions of the government to launch large-scale liberalization in all fields of domestic life: political, social, economic, legal, public. In international terms it may probably aim at convincing the world community of the irreversibility of the domestic reforms, the improvement in business climate, consolidation of stability, and finally, accelerated integration into the system of world relations. Yet the consequences of holding by the line are still due to be assessed.

Trade restrictions hit investment climate, as well as socially unpopular. Whilst they continue they will undermine all other efforts to improve the policy and administrative regime for FDI. Their fundamental solution requires a changed approach to macroeconomic policy in which balance-of-payments management is handled by policy tools than by any others. It is going to be in line with the views of the government too, as the President of Uzbekistan I.Karimov has confirmed the necessity to abide by internationally accepted norms and standards in pursuing foreign economic policy. *"We need to shift over promptly to the civilized, worldwide accepted forms of foreign economic activities..., to create legislative and economic conditions to attract foreign capital into our economy in a more widely way "*, vowed the President I.Karimov, when spoke about national priorities in the new century.³⁰⁹ The aim should be to achieve as soon as possible normal business arrangements in which foreign investors and local business can freely import their requirements and readily pay for them at a market-related exchange rate.

But, exchange rate will obviously be further devalued to prompt other steps in the adjustment of domestic trade practices. In particular, further devaluation of national currency is expected to promote higher revenues from import duties and tariffs on consumer goods, denominated in foreign exchange, which would finally lead to the distortions between domestic and world prices of the similar goods. Such a situation would imply that under import taxes in 2001³¹⁰

economic units. See for example: IFC/World Bank Small and Medium Enterprise Survey for Uzbekistan. www.ifc.org/centralasia

³⁰⁹ Translated by the author from Karimov I. Uzbekistan Ustremlyonniy v XXI Vek. Speech at XIV Session of the Parliament. Newspaper "Narodnoye Slovo", 15 April 1999.

³¹⁰ New import taxes as for 1 January 2004 do not seem to change significantly. Available at www.bisnis.uz

domestic prices for video- and audio appliances would be by 2,1 times, grain products - by 1,58 times, carpets - by 2,64 times higher than the world ones (Annex 5.2). In real terms, it leads the following undesired consequences:

- severe price distortions on goods and services and therefore, inefficient distribution and use of the resources;
- growth of cases of import taxes evasions which generates illegal import, especially in border areas with the countries, which do not apply similar restrictions;
- the prices on consumer goods will apparently be soaring;
- negative influence on the development of export industries³¹¹

The government of Uzbekistan has solid ideas about the pivotal elements in its import policy.

"We should, we are obliged to set up necessary conditions in domestic market, so that those goods, which we can and need to produce by ourselves and for which there are all opportunities, are to be produced in our own territory... Nowadays 75% of all sewing products traded in domestic market, almost 50% of shoes, about 80% of toilet soap and synthetic cleaning means, over a half of locally consumed animal fat and tinned food, (and) actually all the range of home appliances, is of import origin... There appears to be a question: what do our organizations and enterprises deal with? What activities are their leadership engaged in, notwithstanding their responsibilities for production of consumer goods?.. And there are no moves or efforts to look into market - no marketing, no output of demanded products, no application of modern management, no bonus schemes for staff workers through increases of their wages. We devised a broad system of tax privileges to encourage local production of consumer goods. What else has the government to do, what can it give? What kind of conditions should be set up yet, so that our stagnated managerial staff (in enterprises) could work properly? ".³¹²

A few important points could be drawn from this statement. The government follows a certain level of so called "critical import" - the size or volume of import which is allowed to the country both for economic and political reasons, and, therefore expresses primary concern if the domestic economy steps over this bounds. This is the right of any sovereign country to proceed from national priorities. However, as evident further from the words, this approach was attenuated by an extremely poor market behaviour of the local enterprises which

³¹¹ All these aspects are analysed in more details in subsequent subchapters.

³¹² Translated by the author from the speech of the President of Uzbekistan Karimov I. made at the meeting of the Cabinet of Ministers devoted to the outcomes of socio-economic developments in the country in the year 2002. <http://www.press-service.uz/rus/rechi/r02172003.htm>.

presumably had to, but failed to efficiently substitute for the limited import, although many of such local enterprises are usually given certain range of tax privileges in addition to the high level of tariff protection from analogical import. Yet, most of these enterprises still remained heavily dependent on the government and its decisions and thus kept being state units by substance. In such terms, the combination of these factors causes small incentives for such enterprises to follow market principles, accomplish necessary research in marketing, or simply doing better in line with the consumer demand and technological improvements. They factually become producing absolutely unnecessary and undemanded products which finally leads to overloaded warehouses of unsold goods.³¹³ Moreover, the domestic consumers have no choice, but to put up with both unsatisfactory quality and unjustifiable the high level of prices in comparison with potential import.³¹⁴

For these reasons, it needs not to underestimate the general role which imports plays in the encouragement of competition, raising social welfare and economic growth of the country. Competition from import is a stick to punish domestic monopolists and a carrot to show local entrepreneurs which fields are going to be the most profitable. It is true that a discriminating feature of high efficiency in the Asian economies was a flexibility of the entrepreneurs in defining and using the niches in the markets through permanent improvement and expansion of the assortment, as well as of capital funds in reply to the ever-changing situation.

Such flexibility is seriously limited in closed economies or in those which significantly rely on a couple of strategic large investors by providing them the high level of protection from competitive imports and therefore, exclusive market rights in particular sectors of the economy. Investments by DAEWOO (in automobile assembly and component manufacturing), BAT (cigarette manufacturing) and Coca Cola (beverages) were investments of this type, because they were strongly encouraged by the government. In such particular cases, domestic economy runs the risks to be heavily monopolized by a number of companies. In these conditions, there are several controversial issues for policy-makers to confront with, i.e. by providing protectionist measures the policy has to face with the problems of the rationale and the efforts on setting up competitive environment favoring a handful economic

³¹³ Only during the year 2002 alone, such stocks of unrealized goods exceeded the established standards by 3,8 bln.sums or about \$4 mln.USD. The source is the same.

³¹⁴ For example, protective levels of tariffs and other fees for home appliances and electronics to support domestic production show that local prices make almost no difference with the similar imported groups of products embracing tariffs. Without tariffs, the latter become up to 1,5 times cheaper than domestically produced home appliances. If we assume that the costs of production factors in Uzbekistan are not at least higher (actually probably even lower) than in the other countries of the CIS where many of the products come from, one may suggest that domestic producers have rather little incentives to reduce production costs. On the contrary, the retention of the current tariff levels benefits them through protection from outside competition. Consequently locally produced home appliances come to be more expensive that the analogues in the neighbor countries.

units only. Moreover, the theory of such protective import policy points at the two bottlenecks in this policy. The first one is the uncertainty of time needed for local industries to become competitive. If it takes indefinite period of time which also does not guarantee the process of structural transformation to end up successfully, then the costs to society of such process in the long run could be comparatively higher than those potentially caused by alternative short-term adjustment. The second factor underlines that with time gone by, even if the process would be going slowly and its outcome could be questioned, in the long run protectionism may become politically unpopular to be removed, since during this time political pressure, including from a number of lobbying groups, may develop and stay behind the conservative decisions to retain traditional shelter to domestic industries.³¹⁵

The recent system suggested that enterprises with foreign investment are entitled to export “products of their own production” and to import “products for their own needs” provided such products are approved by the government. This is intended as a concession to foreign investors but actually speaks of relatively restrictive approach to a fundamental requirement of business. The concession specifically excludes other forms of foreign investment and all other businesses which act as service providers and suppliers.

Certainly one of the important principles in the long-run should be a system which can equally meet the national interests, i.e. of both domestic producers and consumers. As far as the government relies on selective import policy for economic, healthy and security reasons, import taxes are expected to continue playing important role here. Moreover, at least during so called "transition period", these tariff protections are justified if pursued in compliance with the rules and outcome of the negotiations on a bilateral and multilateral basis with the countries-members of the WTO.

Yet subsequent competition with imports must not be also excluded, since the domestic consumers should have the rights to choose products of better quality among wide assortment. For local competitiveness of real sector to be maintained and enhanced, both productive and technological, import duties should subsequently tend to be reduced. Given the forthcoming long-lasting process of membership in WTO with its bearing rules on rates of duties, the efficacy of customs administration, the freedom to export and import and foreign exchange arrangements will require significant liberalization that would be also be highly beneficial to the investment climate. For this reason, further changes in import policy should take into

³¹⁵ For this reason, the expected protection is to be given to the industries which may satisfy two tests, i.e. that industry is able to become internationally competitive (Mill’s test); and that the industries may pay back social costs too incurred during protection period. See: Dynamic Arguments for Trade Barriers, in Mikic M. International Trade, New York, 1998, p.375

account the aforesaid process of irreversible liberalization and the steps towards it should be taken already today, i.e. before the process of entrance has initiated, in order to show the world community the seriousness of intentions and consistency of the measures undertaken.

Thus, import policy should not necessarily mean the autarchy and isolation from the world community. Moreover, it is not to be a manipulation which gives exclusive and long-term protection to a number of domestic oligopolist companies from foreign competition. On the contrary, there should be a strong understanding of this measure as a forced and temporary step, aimed at giving rise to the particular environment to support and develop certain competitive industries, but which, from the very beginning, should take care of appropriate modernisation, higher efficiency and rapid efforts to produce competitive products, since they have to face clear time limits. It is common knowledge that sustainable development in the long run could be dependent much on the intensive development of export-oriented industries.

5.1.2. Rethinking Commodity-Based Policy Behaviour

The export structure of Uzbekistan on the eve of independence provided $\frac{3}{4}$ of total export revenues, mainly from the export of cotton, gold and other non-ferrous metals, with cotton alone provided $\frac{2}{3}$ of export revenues. At that time, the given export structure considerably reflected objective needs of the republics and played a positive role in stabilization of the abrupt cease of Union's subsidies after the collapse of the USSR. On the other hand, relatively rapid re-orientation of foreign trade from traditional Soviet consumers to the Far abroad made the export revenues sustainable for years. In such conditions, the share of the CIS countries in foreign trade (export) fell down from 69% (82%) in 1992 to 27,6% (22,9%) in 1996. The main reasons of shifts in trade vector were break-up of the traditional economic ties between the ex-Soviet republics, economic crisis touched upon all the states; collapse of the financial system which led to growing non-payments, both domestic and inter-republican, etc. Simultaneously, however, such the situation reflected the shortcomings of the planned system too, with the misallocation of economic resources, highly politicized decision-making process; forced and undisputable measures of the Centre relatively to most of the republics without taking into account appropriate economic and socio-political impacts of those steps. As a result, the Soviet economy continued its stagnation under the pressure of accumulated domestic and external problems.³¹⁶

³¹⁶ The impact of the given system could be revealed not only in the Soviet Union, but also in other Socialist countries, particularly in East Europe. The Eastern European countries were not allowed by the USSR for free trade development with Western Europe, mainly for political reasons. After the development in the "Soviet

In case of Uzbekistan, price factors have also played their role. The country turned out to be an immediate beneficiary of high world prices for cotton in the first half of the 1990s, since it was the second largest cotton export in the world. In such cases, efficient trade policies should have allowed for raising exports and get maximum benefits. Moreover, the rich domestic mineral base made the republic the 8th largest world's gold producer, one of the tens of gas producers, as well as a large exporter of other non-ferrous metals. But what are the perspectives for Uzbekistan to remain as large commodity exporter?

The first concerns on this occasion arose with the severe falls in world prices on the main commodity exports of the country. Another strike on the economy was bad harvest of cotton at that time. Moreover, traditional consumers of the Uzbek staples, Chinese imports of the Uzbek non-ferrous metals, for example, had also come down because of the complex of domestic factors in China itself. The reliability on commodity trade played against Uzbekistan. The country experienced huge losses in billions of foreign exchange which were of great significance for a country, those revenues were heavily dependent on a handful set of goods.

At present, the situation on world markets seems to be quite favorable. Prices for cotton and gold have been soaring in the recent months, which could be explained not only with the structural changes in the world demand, but apparently also with the impact of world currency markets, weakening US dollar, a traditional unit of counting on many transactions in staples in the world markets, as well as by a high degree of uncertainty about the world security and stability. Thus, these moves in prices on commodities could get out of the control for non-economic reasons too, which makes it also difficult to regulate them through pure economic

autarchy”, when the goods and services produced could be traded within the Council for Mutual Economic Assistance (CMEA, est. in 1949) only, the Eastern European economies faced mounting systemic challenges with lower efficiency in production process, uncompetitive products in wider international measurements, domestic deficit of goods, out-of-dated industrial sector. The collapse of the CMEA brought about re-orientation of foreign trade in Eastern Europe (the Czech Republic, Slovakia, Hungary) in favor of the West. The degree to which the administered division of labor within the former CMEA had failed to exploit opportunities to trade with Western countries has been assessed then in a number of studies. For example, so called “gravity models” taking into account two groups of main factors: “size” of trading partners (GNP and population) and “trade resistance” (distance between countries, adjacency, trade policies) revealed that under “normal” conditions East European countries would have exported several times as much to OECD countries as they usually did. It was also estimated that the exports of six European countries to the EU could have been five times higher in 1985. A similarly large discrepancy between hypothetical and actual trade was revealed for East European imports from the EU. Correspondingly, some estimates show that intra-regional trade in Eastern Europe would have amounted to only 27% of total trade, instead of actually 67% in 1985. Similar studies tried to estimate such figures for the former Soviet republics, however they fall shortage of reliable empirical data. Nevertheless, the general trend of the distortions in flows and size of forced foreign trade seems to be in place. According to the available sources, in terms of hypothetical liberalization, inter-republican trade within the USSR would have amounted to 20-40% of its actual performance only. See: Wang Z., Winters L. (1991). *The Trading Potential of Eastern Europe*. CEPR Discussion Paper 610. London; Smith A. *Eastern European Economies, in Eastern Europe and the CIS*, Paris, OECD, 1999. p.62-73.

tools. In such conditions, some ideas are debated on the possibility to set optimum export tariff which is intended to influence the world prices through putting limits on cotton export from Uzbekistan. Taking into account the fact that Uzbekistan is one of the largest producers and exporters of cotton, some authors believe that under particular conditions it is justified for the republic to pursue aggressive price-making and profit-maximization policy.³¹⁷

However, does Uzbekistan really have the sufficient set of tools and opportunities to keep the world prices moving in the desired direction and remaining at the most-wanted level? May exports restraints by Uzbekistan make prices soaring in global terms?

The following considerations come on mind first. Certainly, much will depend on the prices elasticity of demand and supply of cotton, with less elasticity being the most desired and successful case for the republic. However, the actual elasticity of cotton in the world markets seems to be as desirably low, since there are substitutes for cotton. But even with the needed elasticity, it appears to be hard for the republic which does not dominate the world market, because there are other producers, including potential ones. To set up an organized union or structure in the form of a cartel, similar to OPEC, for example, is going to be something complex task not only for economic, but also for political reasons.³¹⁸ The suggested restrictive trade policy would reap its fruits in the short-run, mainly since traditional consumers would find it not suitable to change their supplier and still continue rely on Uzbek cotton for a while. However, in the long run, they would be probably searching for other deliveries too.

The concept of “export restraints” and “optimal export tariff” may look like a well-grounded argument which is believed to serve the national interests.³¹⁹ But in the global perspectives, this kind of strategy seems to be a zero-sum game, even they could result in the unilateral benefits for one country. In general, they may worsen the terms of trade only, and therefore,

³¹⁷ Trushin E. Liberalizatsiya Torgovli: Uroki Mejdunarodnogo Opyta. Magazine *Ekonomicheskij Vestnik Uzbekistana*. 1999, No 11. The author, however, further admits that the given policy may be successful in the short-run only, and seems to be inconsistent in the longer run.

³¹⁸ Establishment of the oil cartel was preceded by the distinctive pre-requisites, different interests and situation in the international relations., immediately around oil and oil-products, but also much beyond these energy resources. Oil by its own is apparently more valuable product today than cotton. On the other hand, the participation in such kind of cartels would provide the country with some leverages of regulation, but also require from it higher integration with the organization, abiding by particular commitments and even political decisions, as well as the risks to be undeliberately involved into political games too. And as the previous experience has shown, the latter factor is one of the main reasons due to Uzbekistan was reluctant to take part in the similar groupings before.

³¹⁹ Equally, however, its effectiveness in terms of the magnitude and distribution of rents will depend on a number of presumptions, including the aforementioned demand and supply elasticities in the importing country, the competitive position of the third-country suppliers, the size of the export quota, and the institutional arrangement for issuing export permits. Find out more on export restraint explanations in Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.343-347.

the world's welfare will apparently diminish too. International experience shows that successful evidence of such policy in real conditions is nevertheless seldom.³²⁰

As another crucial Uzbekistan's exports is composed of ferrous and non-ferrous metals, the policy in this area is also requiring an adequate policy on the national level. One should take into consideration that domestic mining companies have needs in getting normal rates of return, i.e. their income must cover not only production costs, but also leave sufficient room for making profits. To devise policy without doubt is a much easier task than its implementation. The losses coming from lower royalties are obvious, but if these royalties are high enough or inadequate foreign exchange policy discriminates against economic development, then the exploitation of the existing mines or the exploration for new deposits would be similarly less attractive. In particular, implicit taxation of mining industries through overvalued exchange rate, for instance, is going to discourage sufficient investments into these sectors, including foreign. The government would remain the main investor and those funds would not be sufficient in general or even used inefficient in mainly state enterprises which operate in the mining sector. Besides, this is a great burden on government budget whose funds could and should be freed and used in other, more needed areas.³²¹

To sum up, sustainable economic growth in the long run has much more to do with further structural changes in the domestic economy and the development of industries with higher value added with the emphasis on export, than with the short term benefits of volatile commodity exports. Domestic policy with relation to primary industries is better to connect to a number of consequent measures on the national level, such as restructuring, attraction of foreign investments, tax and foreign policies, etc. designed to enhance necessary improvements there.

5.1.3. Domestic Potential for Export Expansion and Diversification

One of the main consequences of the fall in export revenues in the mid-1990s was the feelings about the necessity to develop the new strategy for export expansion and promotion. With the

³²⁰ For instance, the attempt of Brazil to exploit its much more monopolist situation in the world's markets of coffee, failed soon, since high prices for coffee encouraged some new producers. The latter succeeded not only in bringing the prices down, but finally in diminishing the Brazilian share in the world market of coffee. Another example is the OPEC whose actions to use its power in the international arena were successful only up to 1974, but also finally came to nought, both because of changes in demand (energy-saving measures in the main consumer-countries) and supply (raise of production in non-OPEC states) side. All these trends caused the fall in prices for oil in the mids of the 1980s. Yet Hong Kong's clothing exports and Japan's auto and videorecorders exports to the USA and the EU, respectively in the first half of 1980s were more successful in reaping the benefits of export restraints. See: Pomfret R. Foreign Trade Policy For Economies in Transition. Magazine *Ekonomichskoye Obozreniye*, 1998, August; Pomfret R. The Economics of Regional Trading Arrangements, Oxford University Press, 2001, p.330.

³²¹ On the detailed issues in energy sector see Chapter 3.

purposes of export development, increase in export of goods and services, expansion of goods assortment and sales markets, the government Programme for Development of Export Potential for the period till 2000 was worked out.³²² The given programme of measures provided various privileges in domestic taxation and foreign trade. For instance, customs tariffs were abolished for all goods and services exported, except raw materials.³²³ The tax on profits (income) was diminishing with the higher ratio of exports in total production.³²⁴ Growth of revenues in foreign exchange was also freed of profit tax, while VAT exemptions on raw materials used for exported goods, and ad hoc credits and privileged loans up to 3 years were also widely used.

The government of Uzbekistan has made liberalization of the foreign economic activity and promotion of export as one of its top priorities in recent years. There are additional tax privileges for industries to promote export production. From July 1, 2000, export-oriented enterprises were exempted from tax on income from export, and property tax are reduced by 50% under the export ratio runs to 25-50%, is not going to be paid at all, if the export reaches 50% of the output.³²⁵

Simultaneously, the government took regular measures designed to reduce administrative barriers. Export promotion was encouraged both in general and selective manner with relation to branches and industries of the economy, the character of participants, as well as to sources of financing, with a priority on foreign investments. Generally speaking, such a great deal of legislative documents adopted in the field of foreign economic activity was as much essential and necessary as it was in successful economies of South East Asia in its time whose way of export expansion Uzbekistan was trying very much to follow.

These measures, however, did not bring those much-needed results expected by their designers. In many times, successful cases were single, taking the form of distinctive projects in particular fields of the economy.³²⁶ In general, the situation changed little in reply to the

³²² Resolution of the Cabinet of Ministers of the Republic of Uzbekistan No 110 dated 12 March 1998.

³²³ Respective Decrees of the President dated 10 October and 26 October 1997.

³²⁴ President's Decree "On Additional Measures to Encourage Enterprises Producing Goods for Export" of 20 March 1996.

³²⁵ President's Decree "On Additional Measures Designed to Encourage Export Production" of 5 June 2000.

³²⁶ For example, textile works „Kabool-Ferghana Company“ in Ferghana with the participation of the Korean "Kabool textile" was intended to manufacture 25000 tonnes of local cotton fibre from raw cotton. The foreign investor was also committed to provide another \$1 bln.USD for re-equipment, upgrading and technological modernisation of a number plants in the Uzbek textile industry. According to some data, this company export revenues had been amounted to more than \$230 mln.USD during 1997-2001. And since light industry in general and textile industry in particular was among the Government's priorities, any efforts on foreign capital inflows are strongly encouraged. Multilateral donors are also due to back these developments. The European Bank for Reconstruction and Development is lending \$1.2 million to privately held, Tashkent-based Gisad O'zbek, to finance part of the Uzbek textile company's start-up working capital. Gisad O'zbek will use locally produced

legislative steps and required additional policy decisions. Most large exporters, for example, were to function in keeping with the export plans pledged by them before the government. As a rule, only a few of them succeeded such plans. Many of them showed weak export performances.³²⁷ If we take into account that these industries are going to play the key role in industrial development and sustainable economic growth in Uzbekistan, strengthening its position in foreign markets, etc., then much work need to be done in this area. As the Chairman of the State Agency for Ill-Performed Enterprises, pointed out, “*No country in the world has achieved its economic goal so far by following import substitution policy. On the contrary, the countries which expanded their export successfully through pursuing industrial policy, provided their nation with the higher standard of life and economic development*”.³²⁸

Thus, the main impediments to export expansion, among the others, has been the following:

- low competitiveness of the domestic products in the world markets which was caused by high production costs, out-of-dated equipment and production processes, relatively poor quality characteristics;
- ill-financial performance of the enterprises in view of rising non-payments and mutual debts between economic units;
- high transport expenses (transit fees imposed by other countries);
- domestic changes in the countries – traditional consumers of the Uzbek goods (changes in tastes and demand for the Uzbek goods);
- incomplete structural problems (many enterprises still seem to have shortage of new approaches in corporate management, qualitative regulation in finance, efficient and sustainable organization structure, etc.);
- costs of the domestic macroeconomic policies (anti-export bias in tax and foreign exchange regime, trade policies).

In the search of the ways to solve many-sided domestic challenges in the foreign sector, international experience may be very useful. Given the hightened interests for the

yarn to manufacture about 5,000 tonnes a year of knitted cotton fabric, mostly for export. See Mirzakhidova Sh. Razvitiye Eksportnogo Potentsiala Respubliki Uzbekistan. Magazine *Bozor, Pul, Kredit*. 2002, No 2; Uzbek textile plant gets \$1.2 million EBRD loan, EBRD Press release, 22 December 2004.

³²⁷ For instance, the association “Uzmashprom” reached only 54% of its plan targets, “Uzstroyaterialy” (Uzbek construction materials company) - 44,8%, “Uzpisheprom” (Uzbek food industry) - 27,9%, “Uzchimprom” (Uzbek Chemical industry) - 25,2%, “Uzavtoprom” (Uzbek Auto industry) - 25%, National Oil and Gas company “Uzbekneftegas” – only 49,6%. Mirzakhidova Sh. Razvitiye Eksportnogo Potentsiala Respubliki Uzbekistan. Magazine *Bozor, Pul, Kredit*. 2002, No 2.

³²⁸ Saidova G. „Osnovnye Problemy Makroekonomicheskoy Politiki”, Magazine *Rynok, Dengi, Kredit*. May, 1998.

achievements of South East Asia's successful export-oriented development, we find it necessary to summarize once again those important pillars of that success which, to our mind, could be particularly good lessons for Uzbekistan to improve the situation to the better. In the given context, the following lessons from new industrialized countries of Asia are important:

- ❖ sound macroeconomic policies and an unrestricted access to domestic and import inputs were absolutely vital for exporters. As it became clear, they cannot be substituted by specific export incentives. But even though the latter are also significant from case to case, they must be granted very cautiously in order to avoid or discourage rent-seeking activities and minimize budget burden.
- ❖ to pursue import substitution and encourage export expansion seems to be very complicated task in the light of setting up similarly favorable conditions for all. The point here is to prevent a policy-induced bias against exportable products. Thus, the policy regime should aim at equalizing the domestic resource costs of earning one unit of foreign exchange through exports with the domestic resource costs of saving one unit of foreign exchange through import substitution.
- ❖ export subsidiaries mainly granted in the form of tax rebates or exemptions and credit facilities at interest rates below market rates are said to account for greater assistance to exporters than duty drawbacks or exemptions.
- ❖ tremendous marketing and institutional support for business entities from which smaller and newcoming exporters gained especially large benefits.
- ❖ FDI are crucial to the extent, as they may not only provide much-needed capital, technology and human skills, but may also contribute directly to export growth.
- ❖ increasing diversification and technological sophistication of exports which was mainly obtained through steady process of technological transfer and continuous efforts on building up of professional skills and knowledge. Among additional direct measures, intra-regional networking in terms of trade and investment helped also this process considerably.³²⁹

Similarly, East Asia's export success should not be universalized and expect immediate effects on Uzbekistan's export strategy. It has to be admitted that there are a number of

³²⁹ Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995.

distinctions between the countries concerned. These differences are mainly reflected in the following aspects:

- East Asian countries did not face the painful experience of transition economies, including Uzbekistan, which had to cope with an obsolete capital stock and suffered from declining production at the initial phase of economic reforms;
- export growth was achieved in Asia in a relatively open trading environment, while Uzbekistan had been cut off from the immediate foreign trade for the decades of the Soviet rule;
- East Asian economies were export forerunners in a large number of manufacturing industries at times of high world economic growth. On the contrary, the world economy has been stagnating since the 1990s. Moreover, Uzbekistan has to face more severe competition for its exports from many developing countries, including East Asia itself, as well as from other transition economies of the Eastern Europe and the CIS due to similar export structure.

Uzbekistan pursued the two-pronged strategy of import substitution and export promotion. In terms of factors and appropriate conditions to do this job with equal success, Uzbekistan seemed to have come under particular pressure. Introduction of foreign exchange restrictions led to highly appreciated exchange rate of national currency, which was certainly beneficial for import substitution industries. On the contrary, the multiple-exchange rate system and regulation over the whole inflows and outflows of foreign exchange, including also the restrictions on the imports of raw materials via encouraging the higher local content in production even more discouraged domestic exports in favor of the import-substituting industries.³³⁰

In Uzbekistan, a number of particular measures should be thus undertaken to help exports developing on the sustainable basis. These steps might reflect in that:

- both foreign and domestic investors should be equally encouraged to expand export. That means that tax and privileges must not discriminate against any sides.
- subsequent steps on restructuring and privatization of middle and large-scale state enterprises need to be intensified to attract foreign capital in the forthcoming years. The

³³⁰ See also Pomfret R. Foreign Trade Policy For Economies in Transition. Magazine *Ekonomichskoye Obozreniye*, 1998, August.

experience of some East European economies, such as Hungary, the Czech Republic and Poland, points at the efficient cases of FDI inflows in the recent past.³³¹

- conditions for small and medium-sized business need to be set up to expand their opportunities on the regional markets of the CIS and Central Asia. In some cases, the role of the government is critical to support these long-run and promising trends. This support could come either through the targeted incentives or mutually advantageous schemes of collaboration with the larger domestic companies which could do this job better in view of more financial and management capacities.
- foreign exchange, tax and customs policy measures require concerted adjustments.³³² According to the legislation, for example, only export in foreign exchange could be exempted from VAT. If the given exemption were viable for all the exports, it would increase its level on aggregate.³³³
- improvements in trade policies would suggest to pull aside restrictive and administered tools. The list of the banned exports, for instance, could be in no need anymore. As domestic and world prices equalise, better export opportunities are available if the elements of direct bans are abolished. It would be in compliance with the non-interference principle of the government contributing to its higher credibility.
- measures are equally necessary to encourage export and import operations not only in foreign exchange, but also in national currency. The division of operations to be carried out in foreign exchange and in national currency should now serve more as a tools of

³³¹ Foreign Direct Investments: New Trends in Transition Countries. The World Bank/William Davidson Institute, *Transition*, October 1999. See also: Rojec M. The restructuring of firms in foreign privatizations in Central and Eastern European countries. Magazine *Transnational Corporations*, Vol.10, No 3.

³³² The experience of South East Asia suggest the following useful lessons in this regard. *Before* a variety of export promotion measures were introduced, the multiple exchange rate system was replaced by a unified rate in Taiwan in the 1960s. The effective devaluation amounted to 60% for exporters that was also followed by a number of administrative, fiscal and trade supportive measures. Consequent measures to promote domestic export in Korea, for instance, were also *followed* by a major devaluation of national currency in 1964 which played additional encouraging signal for domestic producers. On the contrary, insufficient trade reforms and liberalization efforts in Indonesia appearantly to be unable to completely remove the anti-export bias of government policies, including the negative consequences of the so called Dutch disease syndrome. Being more well endowed with natural resources, the country proved to show less impressive economic performance than other economies of the region. Thus real exchange rate policies was critical aspect of export promotion, regardless before or after the package of complementary incentives had been introduced. Find out more in: Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995; Chung H.Lee The Economic Transformation of South Korea: Lessons for the Transition Economies, OECD, 1995.

³³³ Sirajiddinov N., Gulyamov R. Reforma Vneshnetorgovoy Politiki v Protsesse Liberalizatsii Valyutnogo Rynka Uzbekistana. Magazine *Halqaro Munosabatlar*, 2001, No 3.

accounting and must not thus be the ground for granting some sorts of privileges or pursuing discriminatory actions, as it was in the past.³³⁴

- reliable transport communications system needs to be developed to help export development. It means that appropriate additional measures could be essential in speeding up and raising efficiency of cargo traffic from Uzbekistan to the CIS and other countries, including the signing, if necessary, inter-governmental agreements on tariffs, transit fees, etc. both on bilateral and multilateral basis.
- trade links with traditional partners and consumers from the nearest regions, such as the CIS, for example, has to be strengthened. It is not only economically viable given transport costs form a high content in the Uzbek exports, but the established links are important in revealing prospective markets in Europe or Asia through the concerted efforts with the neighbors.

One of the important elements to sustain export in the long-run is a question of technological improvement through the transfer of technologies and expansion of local technological capabilities. The transfer of technologies to Uzbekistan may occur in different forms, either through construction of turn-key plants or technology licensing and the purchase of equipment. Here there is a dilemma for the national policy. In the first form, new technologies are not only supplied, but also used under strict control of foreigners consequently requiring the limited use of local factors, mainly only labor force. It certainly may find little countenance among the local leadership for fear of losing the key levers of control in economy. It may have also limited influence on technological learning. In turn, two other forms are efficient to the extent, to which the user can obtain and process sufficient information to choose among available techniques, and to adapt the new technology to local conditions with only limited support from the suppliers. Yet although the local users would be sovereign in using these technologies and the state may retain its strategic control, the equipment would still remain dependent on the imported spare parts, raw materials and maintenance services provided by technology suppliers.³³⁵

In addition, one may expect that firms in industrialized countries will hardly transfer proprietary technology to potential competitors in the world markets if this is likely to

³³⁴ The initial important step in this direction has already made. The decision to hold auction sales on strategic commodities (cotton, benzine, diesel, non-ferrous metals) on the Republican Commodities Exchange was crucial, even though these commodities are supposed to be traded for domestic consumption only. It is certainly also true that further steps should be done to open these trades for export also.

³³⁵ Such practice was quite the case in Eastern Europe in the end of 1960-beg. 70s when limited attempts to open domestic economy to foreign investors and required modernization resulted in controversial results. See: Smith A. Eastern European Economies, in Eastern Europe and the CIS, Paris, OECD, 1999. p.64.

undermine their competitive positions. In this case, two trends may appear to develop: either Uzbekistan will benefit from inflowing outmoded technology, or modern technology may come on the condition of export markets segmentation. To all probability, if foreign investors are attracted in the export oriented industries, as the main contributors of technologies and funds, the following is better to take place. An exporting firm in Uzbekistan may concentrate on manufacturing operations while their partners abroad will be responsible for product design, quality control, and marketing.

As the next stage, to build up technological and management capabilities are necessary. One needs to understand that channels of technological transfers is crucial, but not sufficient element. Technological capability may be defined as ability of local firms to select, adapt, and apply hitherto unknown technologies. From this point of view, there is a lot of debates which point at the high educational level in almost all transition economies as a very strong advantage to attract FDI and pave the way towards sustainable economic growth. However, in fact it is very hard task to determine direct influence how the high level of education may influence economic growth, at least in short period of time. The more modern viewpoint emphasizes that learning on the job is more precise and important alternative form of human capital formation. It occurs as a result of gathering experience in the performance of new activity, in the sense that the time required to perform a certain task declines with cumulative output. It allows the professional qualifications of many members of the labor force to improve simultaneously, while in case of general education, for instance, the skills of labor force can normally change very slowly and if only new entrants have a higher educational level than those who leave the labor force. In this context, the main policy implications are so that further emphasis in government policies should be made on maintaining strong investments, especially private, not only into a good educational system of general education, but also in the schemes which would encourage permanent up-grading of technical and managerial skills.

Finally, if the country wants to face sustainable export boost, the crucial role of institutional and marketing component should be taken into consideration. The export promotion success across the Asian region, led by Japan, was significantly contributed to this factor and appropriate policy measures. All countries which chose the outward-oriented strategy tackled the issue on the national level by creation appropriate organizational structures most of them financed by state budget. For instance, in Japan, that was Japan External Trade Promotion Organization (JETRO), in Malaysia - Malaysia Trade Development Corporation (MATRADE), in Singapore - Singapore Trade Development Board (TDB), in Korea - Korea

Trade Promotion Corporation (KOTRA). In addition to direct privileges and subsidies in form of tax exemptions, drawbacks, credit and financial facilities, as well as extremely favorable general environment, the Asian governments provided wide range of indirect assistance to its exporters through the given agencies which was reflected in collecting and distributing market information, finding customers for their products, advertising products abroad, etc.³³⁶

Given the strong need of domestic exporters in Uzbekistan for such kind of assistance in the past, further policy in this area should be drastically improved. It is absolutely clear nowadays that reliance exclusively on trends in foreign markets is not more enough and even dangerous. Efficient outward-oriented policy requires efficient institutions to take care of export interests in foreign markets and investments rather than relying on the initiatives of foreign buyers only. One needs to help domestic firms in creating the proper trade channels for exports and expanding an access to commercial and other necessary information on foreign markets. This could be reached by providing assistance in marketing new products and services, product development, including product design and packaging, training in marketing, participation in trade fairs and exhibitions, searching for potential partners, etc. In the long run, one may expect that in a row with public agencies of this kind, there will be also private trade associations which can subsequently coordinate their efforts in pushing forward and protecting interests of all exporters.

5.2. The Significance of Foreign Direct Investments (FDI) in the Foreign Economic Strategy of Uzbekistan

5.2.1. Necessity, Role, and Advantages of FDI in Economic Development:

Global Trends and Features

History of world economic development has many interesting and useful lessons for all transition economies. If Uzbekistan has committed to follow liberalization in the foreign economic sector with the purpose of closer integration into the world community, it becomes of a particular significance to realize those tendencies which have driven the world community for the last decades. International experience is rich in the cases of withdrawing benefits from the division of labor and cooperation. Intense cross-border movements of capital has become one of the crucial aspects of such development.

³³⁶ Alimov A., Muminov R. Liberalizatsiya Vneshneekonomichskoy Deyatelnosti (Mirovoy Opyt i Problemy Uzbekistana). Magazine *Rynok, Dengi, Kredit*, 2000, No 11; Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995.

It is common knowledge, for instance, that one of the main components of sustainable development in South East Asia (SEA) was played by the substantial inflows of foreign capital and appropriate domestic policies. However, the impact of Asia's attractiveness for FDI on its export-oriented development is difficult to quantify. Nevertheless, the proposition that large and rising inflows of foreign capital have significantly contributed to sustainable export growth, seems to be well-grounded. Some empirical analysis showed, for instance, that FDI and trade flows were positively correlated.³³⁷ Higher outflows of FDI from Germany, USA and Japan, the largest sources of the global FDI, to industrialized and developing host countries went hand in hand with higher exports from host to home countries of foreign investors. The steep increase of world-wide FDI over the last two decades, and close links between trade and FDI could be attributed to globalization strategies of multinational enterprises. Innovative production techniques dramatically reduced transaction and communications costs. The liberalization of capital markets and related developments have added new dimensions to the international division of labor. Production processes could increasingly be fragmented and relocated to countries offering the most favorable conditions for producing certain goods or parts thereof, which could be supplied on world markets at competitive terms.³³⁸

These FDI to South East Asia were mainly world-market oriented, rather than domestically oriented, and, thus, were directly linked with export expansion and export diversification at the host countries. Japanese firms which were among leading investors in SEA, are especially well-known for their world-market orientation. In countries, like Malaysia, the Philippines and Thailand, foreign firms accounted for more than half of manufacture exports. Furthermore, much of the region's export activity has been in sectors in which FDI and the associated transfer of technology and industrial know-how have been substantial. In this

³³⁷ Nunnenkamp P., Gundlach E., Agarwal J. (1994) Globalisation of Production and Markets. Kieler Studien, 262, Tuebingen.

³³⁸ In 2002, for example, FDI to developing countries of Asia, including NIC, China and India, amounted to more than 11 times the figure of 1987. The region's share in total world-wide FDI flows soared to 26% in 1993 and went down to about 14% in 2002, mainly because of severe competition from other regions, especially Central and Eastern Europe, as well as a result of massive financial crisis in 1997-1998. See for more details Agarwal J., Laughannan R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995. p.21; Foreign Direct Investments: New Trends in Transition Countries. The World Bank/William Davidson Institute, *Transition*, October 1999, p.7; UNCTAD Handbook of Statistics 2003; UNCTAD World Investment Report 2003, http://www.unctad.org/en/docs/wir2003overview_en.pdf

respect, both FDI in, and manufactured exports of SEA shifted to more skill-intensive industries.³³⁹

It needs to be stressed that one of the strongest benefits of FDI comparing to other forms of investments is that they are carried out on the long-term basis and mainly directly into production. This makes their influence on host economies more sustainable and prevent any negative short-term outflows of capital which may damage so far the fragile system of economic relations in small economies similar to Uzbekistan.

Notwithstanding significant foreign stocks in Asia in the mid-1990s, some new trends in the world distribution of financial flows were seen due to alternating financial and economic crises in Asia, Russia, Brazil in the second half of the last decade, and the measures undertaken in other recipient-countries. Total volumes of FDI inflows in Central and Eastern Europe hit a new record - almost \$29 bln.USD, yet FDI flows were uneven across the region by increasing in 9 and falling in 10 economies in 2002. Moreover, this figure is much less than the corresponding indicator in China which alone proved to be the second largest recipient of FDI (about \$53 bln.USD) and the largest economy by FDI stocks in the world in 2002.³⁴⁰

However, it changed little when traditional geographical movements of FDI across the world are concerned. Although, for instance, outflows from the EU to Asian developing economies increased significantly, when the periods of 2000-2001 and 1986-1987 are compared, the region remained a minor host for EU investors who preferred intra-regional engagements during the process of European enlargement towards East. There seems to be developing consequent and severe competition for foreign investments between the regions, who are potential recipients, as well as between those, who serve as a source of world-wide investments. While Eastern Europe consolidates its positions in targeting Western European markets and investors, Asia remains abiding to the US and Japanese markets.³⁴¹ On the other hand, the distance between recipient and donor countries is also taken into account. So called “gravity models” reveal, for example, that for each doubling of distance, trade between two

³³⁹ Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995. p.22

³⁴⁰ UNCTAD World Investment Report 2003, http://www.unctad.org/en/docs/wir2003overview_en.pdf

³⁴¹ Some researches in the past revealed that within the regions, further division of places of investment location between the main contributors was further continuing. So, US FDI stocks in manufacturing industries of SEA reached 7,2% of US world-wide FDI stocks, while share of Japan reached 1/3 of total outflows in manufacturing industries of Asia in 1992. When main recipients of US FDI were Singapore, Hong Kong, then Japan shifted from initial new industrialized countries to ASEAN (Indonesia, China, Malaysia. Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995.

countries of similar size diminishes by two thirds. A common border, on the contrary, tends to increase trade links between corresponding states by a factor of 2,5.³⁴² Thus, the competition between the regions seems to be further under way with the emergence of new transition economies to behave as the viable alternatives to European and Asian companies in various industries.

Nevertheless, the aforesaid tendencies worldwide do not diminish, but reinforce that crucial role which FDI could play in Uzbekistan too. Such a reliance on foreign capital should coincide with the whole strategy of national reforms in the foreign sector. In particular, this interrelationship is seen in the following important aspects:

- a) FDI may contribute to the liberalization campaign, pledged by Uzbekistan, especially through further reforms in the foreign sector. That would imply demonopolization of foreign trade by encouraging the more active involvement of domestic private sector and giving support for foreign investors. The latter are able to assist in reinforcing domestic competitive environment and finding out national competitive advantages of the country in international perspective.³⁴³
- b) The 2004 Investment Programme of the government was about to reduce centralized state investments into the domestic economy, in view of expected higher volumes foreign assistance. In particular, \$1,028 bln.USD of investments for 92 projects were expected to be attracted, a little bit more than in the previous year.³⁴⁴
- c) International experience is rich in successful examples which point at the key role of FDI in pursuing efficient structural changes, developing export industries through further expansion and diversification, creating competitive environment, as well as encouraging further modernization of branches and providing products of better quality.³⁴⁵ Therefore, the country needs consequent strategy with proper national actions to keep up sustainable inflows of capital.

³⁴² For more details see Balassa B., Bauwens L. (1989) The Determinants of Intra-European Trade in Manufactured Goods. In Jacquemin A., Sapir A. (eds) The European Internal Market. Trade and Competition, Oxford.

³⁴³ See more about the role of FDI in UNCTAD World Investment Report 2002: Transnational Corporations and Export Competitiveness. <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2477&lang=1>

³⁴⁴ In 2003, the volumes of suggested foreign investments in the Government's investment programme was equal to \$860,44 mln.USD. However, two thirds of these investments were due to be attracted under government guarantees. Therefore, much work needs to be done to improve legal conditions and the mechanism of applying other forms of guarantees required for foreign investors. Zarudnaya V. Pravitelstvo Delayet Stavku na Investitsii. www.zamon.info 18 December 2003

³⁴⁵ Rojec M. The restructuring of firms in foreign privatizations in Central and Eastern European countries. Magazine *Transnational Corporations*, Vol.10, No 3 <http://www.unctad.org/Templates/webflyer.asp?docid=1776&intItemID=2926&lang=1>; Rajah R. Systemic

- d) In terms of the limited domestic resources, FDI would allow not only to cushion the given problem by providing necessary funds, but also ease the burden of expenses on domestic budget. The freed state funds could be efficiently used in pursuing more ambitious and targeted reforms in other fields, such as the development of legislative and court system, the improvement in designing guarantees for private domestic and foreign investors, the improvement in national governance and tools of macroeconomic policy, targeted welfare programmes, etc.
- e) Uzbekistan remains underperformed in some specific areas with the potential still to be tapped. It seems that the government also see the bottom of the given issue. *“We can not be happy with the state of affairs in attractinng foreign investments into the processes of privatization of large-scale enterprises. It is especially true for the enterprises in the frame of the National Oil and Gas Holding “Uzbekneftegas”, Company “Uzstroyaterialy” (construction materials), the State Joint Company “Uzkimyosanoat” (chemical industry) and many others”*.³⁴⁶ Let alone the quality dimension of the privatization process, the point concerns poor FDI performance in lucrative mining industry which can give an additional impetus for higher foreign investment.³⁴⁷

In general, for the whole Central Asian region and Uzbekistan in particular, it is crucial to become beneficiaries of the world capital inflows, as SEA succeeded in doing so in its time and what Eastern European countries have been trying to do after the 1990s. Significant distance from the main sources of FDI in the world, however, puts on the agenda a number of socio-political, macroeconomic, legal issues to be addressed on the national level. In its turn, this requires appropriate analysis of factors and conditions to drive FDI inflows.

5.2.2. Driving Forces of FDI Inflows

In order to perceive the reasons and motivations of foreign investors on whether to invest or not into particular country under specific conditions and time, one needs to set out the forces under which investment decisions are taken. Besides, it is also crucial that the major

coordination and the development of human capital: knowledge flows in Malaysia’s TNC-driven electronics clusters. Magazine *Transnational Corporations*, Vol.11, No 3.

<http://www.unctad.org/Templates/webflyer.asp?docid=3334&intItemID=2926&lang=1>

³⁴⁶ Translated by the author from the speech of the President of Uzbekistan Karimov I. delivered at the annual meeting of the Cabinet of Ministers on the socio-economic developments in the country in the first half of 2003. Newspaper “Narodnoye Slovo”, 19 July 2003.

³⁴⁷ The question of efficient state policy with regard to proportional distribution of FDI among the sectors of the economy in line with national priorities is another aspect which needs particular consideration.

contemporary international trends in worldwide FDI requires the clear assessment and reactions on the high level, i.e. by designing and pursuing national investment strategy.

Let us start with some theoretical issues. There is vast amount of literature explaining FDI movements between countries. The inflow of FDI in transition economies, therefore, stands on various factors in both host and home countries of investors. Given the range of potential motives, it is very difficult to provide a single model covering all possible circumstances, because they may differ substantially from country to country. Thus, we try to define and generalize the factors which could be subsequently attributable to Uzbekistan.

The issue why FDI movements worldwide have become so huge for the last three decades among other factors has much to do with the theoretical explanations. One of them stems from the Heckscher-Ohlin theorem on the differences of the production factors endowment in various economies.³⁴⁸ It states that under the conditions of identical and homothetic preferences, balanced trade and non-reversals of factor intensities, each country exports commodity which requires for its production the relatively intensive use of the factor found in relative abundance in that country. In other words, the question is about the relative availability of capital (K) and labour (L) in the host countries for foreign investments to be competitive in production of goods and services. In transition economies, in this respect, the proportion between these two factors, i.e. K to L is much lower than in the developed countries, due to lack of capital and excess of labor. That means that any additional injection of capital unit would mean high return per unit of capital invested, or higher marginal productivity of K, in comparison with investments at home. Consequently the strategy of profit maximization makes investors to seek for such places where they can reap the benefits from more efficient use of their capital.

The new classical theory of economic growth backed mainly by the international institutions is based upon the assumption that real interest rates differentials adjusted to the fluctuations of foreign exchange rate is the main driving force for FDI, i.e. where the interest rates are higher, then, FDI will move into these countries. However, this theory does not explain, why the FDI move in opposite directions too, i.e. into the countries with lower interests rates.³⁴⁹

Severe competition between transnational corporations (TNC) in the regional and international markets gave rise to the theories of product cycle on the basis of technological

³⁴⁸ The Pattern of Trade and the Heckscher-Ohlin Theorem, in Mikic M. *International Trade*, New York, 1998, pp.76-81.

³⁴⁹ Abdurahmanov M. Faktory Privlecheniya Pryamyh Inostrannyh Investitsiy. Magazine *Ekonomicheskoye Obozreniye*. 2003, No 11.

gap between various countries: a country in which an innovative process occurs will thus have a comparative advantage to export the new product to technologically less developed economy even with no clear evidence of comparative advantage in terms of factor endowments.³⁵⁰ The product-cycle theory then states that due to the fact that throughout the life cycle of the product its input requirements change, the comparative advantage will shift from one to another, less developed country depending on their overall factor endowments and production conditions. It finally means that after the technology of production to become completely standardised and universally available, TNC look for the transfer of technology to the least-cost producing country to increase their profits and remain competitive.

Very similar to that, but more comprehensive and well-accepted theory explanation of FDI worldwide is the Theory of International Production which postulates three advantageous conditions for FDI: in ownership, location, and international advantage. The *ownership* in the given context means the comparative advantage of the investors before home producers in privileged possession of intangible assets. One example of such assets is technology, which is broadly defined as any kind of economically useful knowledge, for example, on lower production costs and competitive advantage. It may both in form of a patented process and the common knowledge of a group of employees. In most cases *locational advantage* is explained by the difference in the aforementioned resources (K and L), trade barriers or transport costs, when FDI is economically more viable to fulfil than direct export of goods to these countries. *Internationalisation* means that the aforementioned intangible assets exploitation costs should be less of any other means, such as licensing or outright sale of a patent or even export of final product. In addition, one view suggests that the advantages to the TNC from operating productive activities in several locations stem from horizontal and vertical integration between various activities of the given firm. Horizontal integration supposes to locate production process and sales in one country, while providing joint inputs, such as R&D, advertising, accounting, marketing and distribution, from central headquarters to serve production activities in other country. Whenever there are cost incentives for the integration of related activities within a single firm and factor costs or other incentives for the separation of these activities geographically TNC will be encouraged to expand investments in global

³⁵⁰ Every product goes through several stages in its lifetime, i.e. new product stage, maturity stage, and standardised product stage. The factors needed for its production in each stage are believed to be different. The issue what causes and why innovative process is initiated and takes place in home countries of TNC is linked to their potential to R&D and the availability of factors for it to exist, such as human capital (scientists, engineers, etc.), technical equipment, high level of savings to maintain domestic investments into R&D, and institutional factors (tax incentives, laws, etc.). Given high costs, both innovative and subsequent production, as well as relative uncertainty about sales, first consumers for these products are found in rich countries. See more: Micic M. Technology-based Trade Theories, in *International Trade*, New York, 1998, pp.230-233.

terms. Vertical integration makes emphasis on intra-firm trade in inputs rather than on the mechanism dividing into immediate production activities and headquarters services. Firms with production facilities in more than one country trade in differentiated products, including intermediate components, finished goods and headquarters services.³⁵¹

In terms of transition, several other determinants of FDI may also be of particular significance. The most important of those are political and macroeconomic stability, with particular requirements to low inflation and stable exchange rate, institutional and infrastructure development, size and growth of the host market, labor costs and productivity, and trade liberalization.³⁵²

What could be derived from the international experience is that the applicability or compatibility of the aforementioned theories may not result in the expected results. That is because the significance of each factor of FDI may vary from country to country, and also over time. Looking once again at the group of South East Asian economies, for instance, one may reveal that even the common picture on the whole shows a success on encouraging FDI and linking it to export promotion strategy, within the group itself countries applied divergent strategies at various development stages. Following the Japanese example, Korea and Taiwan erected barriers against FDI at the early stages on the grounds that it would limit the scope for the build-up of technological capability of nation-owned firms. On the contrary, Malaysia and Thailand actively encouraged FDI. Being much better endowed with natural resources than South East Asia, India and Brazil were marked with less impressive policy for FDI encouragement which did not bring designed results, not the least because of general orientation toward import substitution.

Or even, in case of interest rate differentials between the countries, there were empirical data that FDI inflows had been marked not only towards one direction with higher interest rates, as the theory suggests, but on both directions.³⁵³ Thus, cross border movements of TNC are becoming strongly encouraged by the pursuit for lower costs of production and higher profits. One evidence of this process could be seen in the trend which has been changing steadily for the decades. Although industrial countries themselves remain the largest recipients of FDI flows, their share fell from about 81% of the global FDI in 2001 to 65-70% in 2003. This

³⁵¹ Foreign Direct Investments and Multinationals, in Micic M. International Trade, New York, 1998, pp.267-272.

³⁵² Blatter T.S. FDI in Transition. Free University Berlin. Institute for Political and Economic History. 11 November 2002.

³⁵³ Abdurahmanov M. Faktory Privlecheniya Pryamyh Inostrannyh Investitsiy. Magazine *Ekonomicheskoye Obozreniye*. 2003, No 11.

conservative trend is apparently continue changing, as new markets of the transition economies or elsewhere will be further liberalized and suggest steady absorptive capacities for investments.³⁵⁴

A number of other questions are also important to reveal which of the factors could play pivotal role in determining FDI into Uzbekistan and, how national strategy should deal with them in order to put this process on sustainable footing. Moreover, what the role of government policy is going to be in this regard: whether it must be further targeted by tackling priority areas of development and specific sets of business, or whether a bigger role of market-driven forces may be required, with the state oriented more on finding out and pursuing appropriate linkages between the reforms in main areas of domestic life.

The general model of an open economy looks like the following: $X-M=S-I=Y-C=I(f)$, where X – export, M – import, S – savings, I – investments. Y – national income, C – consumption, I(f) – foreign investments. National income partly consists of consumption (private and state), and savings after consumption. Domestic savings are an important source for keeping up investment process. The imbalances between savings and investments pre-determine to a substantial degree the interlinkages and further changes in the key areas, as well as processes in domestic economy, including macroeconomic policy. For example, if demand for investments exceeds national income, then the model shows lack of domestic savings to keep up the internal investment process. Therefore, this shortage is going to be redeemed by the additional funds from outside.

According to some estimates, share of total domestic savings in GDP of Uzbekistan fell from 27% in 1995 to 19-20% in 2000-2001, mainly because of the reduction of savings in real sector – from 15,7% to 5,1% GDP. The given difference, i.e. lack of savings between domestic savings and investments was basically compensated with substantial foreign borrowings of real sector.³⁵⁵

The rate of domestic savings is much lower than in South-East Asia in the beginning of the reforms there in the mid-1970s.³⁵⁶ It is going to be a great concern, because in the long run domestic savings have to be a main source of domestic investment process. Therefore,

³⁵⁴ IMF (2001) Balance of Payments Statistical Book Classification; UNCTAD World Investment Report 2003, http://www.unctad.org/en/docs/wir2003overview_en.pdf

³⁵⁵ According to some calculations, the difference between savings and investments remains at least 8-10%. Chepel S. *Ekonomicheskii Rost Za Gody Nezavisimosti: Faktory, Problemy I Perspektivy*. Magazine “*Ekonomicheskoye Obozreniye*”, 2003, No 6.

³⁵⁶ According to data available, this indicator was ranging from about 15% in South Asia (India) to 35-40% in East Asia (Hong Kong). Source: Agarwal J., Laughannen R., Luecke M., Mannerkamp P. *Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia?* Institut fuer Weltwirtschaft, Kiel, November, 1995.

without tackling the given issue and undertaking necessary efforts to run up this figure to higher levels, one may hardly expect sound and consistent economic growth and prosperity.

In terms of Uzbekistan, the scanty resources of domestic economic units in the transition period were also covered by foreign inflows, mainly in the forms of credits and loans. However, one of the consequences of these trends became the situation, in which the continuous borrowings of such kind in terms of poor export performance had resulted at the certain stage in worsening national balance of payments because of disruption in capital and current accounts. Eventually this may bring out reductions in official foreign exchange reserves and contribute to higher foreign debt.³⁵⁷

On the other hand, the continuous use of foreign restrictions in the past brought about not only immediate distortions in prices and using domestic resources, but also evoked rent-seeking activities resulting also from vague and complicated domestic legislation concerning foreign investments. Direct foreign exchange restrictions, burdensome legislation, uncertainty in interpretation, as well as unexpected and often changes have been seen as the main risks of doing business.³⁵⁸

This kind of problems were often in the spotlight of many international research and regular analyses of the situation in the country, as well as in independent polls and surveys provided by foreign governmental and non-governmental institutions. Much attention is given not only to a particular issue, single steps or achievements in some areas, such as current account convertibility. They also point out to the necessity of steps on wide range of issues, such as in-depth and crucial reforms in better governance, banking sphere, legislation and court system, democratic and political processes.³⁵⁹ In general, a full range of potential factors of FDI cross-border movements could be summarized in a single table (Annex 5.3).

The last elements are new and bear corresponding political implications in this regard. The question is open to debate, whether and how the level of democratisation in the society may influence efficient economic prosperity, let alone economic calculations of these effects. Most of the Asian countries achieved their success with authoritarian regimes with few exceptions.

³⁵⁷ *Uzbek Economic Trends*, TACIS, Quarterly Issue, Tashkent, 2000. See also EBRD Transition Report 2003: Integration and Regional Cooperation. <http://www.ebrd.org/pubs/index.htm>. According to statistical data, one may judge that the country's foreign debt indicators worsened especially in the second half of the 1990s, when the country made a few foreign borrowings, basically on commercial basis. The current account situation, however, continued inconsistent performance with the fall in exports and persistent high level of import at that time.

³⁵⁸ Khamedov A., Atabaev E. O Nekotoryh Aspektah Pravovogo Regima Eksporta Tovarov v Respubliku Uzbekistan. Magazine *Halqaro Munosabatlar*, University of World Economy and Diplomacy, 2002, No 2.

³⁵⁹ See: IFC/World Bank 2003 SME Survey for Uzbekistan. www.ifc.org/centralasia; Transition Report 2003: Integration and Regional Cooperation. <http://www.ebrd.org/pubs/index.htm>.

On the contrary, other countries (Argentina, for example) regained the credibility of their governments and economic policies only after the moves towards democracy. Nevertheless, these kind of issues have been pushed forward in international circles very often for the recent time, especially when the issues of FDI and foreign loans and credits are under consideration. Although it may be not the primary issue in corporate strategy in most transnational companies, such criteria are actively becoming an integral part of the main multilateral and bilateral donors and governments. The vivid examples of raising this issue up to the national level is the policy of the USA and the EU whose foreign assistance programmes, above exclusively economic matters, define security and democratization and political processes among the top priorities to be developed in recipient countries. Security and stability in these societies are considered in new dimensions, that is in the frame of human security and full realization of his rights and opportunities.³⁶⁰ The same position is distinctive in EBRD and World Bank which have gradually been changing their strategies from general resource allocation towards targeted projects with specified conditions on a wide-range basis.³⁶¹

This view seems to be shared by the government too. At least, it was specifically outlined in the Uzbek President's speech that *"the reforms in the economy could not be successful if they are not instantly interlinked to similar profound reforms in the political sphere, the system of state, and in the judiciary system. At a particular stage the process of reformation and modernization of a country inevitably stretches against the unresolvable challenges if these reforms in various fields are not correlated with each other through the common targeted tasks and common ideology. Just for this reason, the two fundamental principal purposes which we put ahead, i.e. cordial democratic transformation and formation of a free market economy in the country, must be the interrelated and complementary tasks"*.³⁶²

Such approach is expected to be reinforced further across the world, as it becomes clear that the marginalization of people does not conducive, but threatens desired stability and security. This view urges to seek for strong interrelationships between the economic, political and social components of stable and prosper development. In turn, the insufficient expansion of democratic values may also impede economic progress and prosperity through less efficient

³⁶⁰ Promoting Long-Term Stability in Central Asia: US Government Assistance the Year After 9/11 Bureau of European and Eurasian Affairs Washington, DC. November 27, 2002. <http://www.state.gov/p/eur/rls/fs/15560.htm>

³⁶¹ EBRD Issues New Strategy for Uzbekistan. Press Release 16 March 2003. It was also stressed, however, that applying certain criteria may differ and require "taking the most appropriate steps to make progress". See also Press Release dated 23 April 2004. <http://www.ebrd.org>

³⁶² Translated by the author from the speech of the President of Uzbekistan Karimov I. delivered at the meeting of the Cabinet of Ministers devoted to the 2003 outcomes of socio-economic developments in the country. 7 February 2004. <http://www.press-service.uz/rus/rechi/rechi.htm>.

economic reforms, less credibility of governments, and therefore, weak private initiatives and a slow confidence-building process. This is especially vital if the country wills to attract and benefit from larger volumes of FDI global movements.

It has to be mentioned that as further foreign investments are available if the property rights perform well, the rumours and business experience in host countries are another information sources in the Western business circles. Business circles are seeking for and relying on information from a broader range of sources which are not necessarily consistent with the officially published investment guides of the host countries' governments.³⁶³

5.2.3. Legislative Guarantees for FDI

The pivotal element of domestic foreign economic policy after independence was to set up legislative and institutional framework for the reforms. A great number of legal documents were adopted and appropriate measures were undertaken to develop legal base in the foreign sector. The pillars of these efforts were the national laws “On foreign economic activity”, “On foreign investments”, “On activities and protection of the rights of foreign investors”; as well as the Customs and Tax Codes, the Law “On enterprise” and others.

*“The development of legal base to attract larger foreign investments into the economy, providing the reliable rights and guarantees designed to protect the interests of foreign investors is going to be of main significance for the future of Uzbekistan”.*³⁶⁴

The foreign investment law, for example, permits foreign investors to invest in any business activity which is not otherwise prohibited by legislation. There appear to be no business activities from which the foreign investment law, or any other law, precludes foreign investors in order to reserve such activities exclusively for national investors. There are a number of activities for which licences are required but these appear to be a standard list of areas involved with national security, public health and safety, natural resources, financial services and professional practice for which both local and foreign participants would need to obtain a licence. Foreign investors may invest through the usual legal forms including the acquisition of real property, the establishment of branches and through shareholding in Uzbek companies. The foreign investment law thus provides a framework which appears to be substantially open

³⁶³ *Uzbekistan. Foreign Trade Barriers in the National Trade Estimate Report on Trade Barriers 2003.* Executive Office of President of the US. Worldwide Country Analysis. On-line version available at: <http://www.ustr.gov/reports/nte/2003/uzbekistan.pdf>

³⁶⁴ Translated by the author from Karimov I. *Uzbekistan na Puti Uglubleniya Ekonomicheskikh Reform*, Tashkent, 1995, p.38

for foreign investment in all forms and in all areas of business available to a national investor. The entry requirements appear to be straightforward, the performance requirements are minimal and investors are guaranteed the right of exit and fund repatriation.

It needs to be emphasized that such steps at the national level aim at the formalization of the consecutive measures on creation of the favorable climate for capital inflows. International experience reveals, however, that it was not always easy to put the declared goals into action. Although such commitments in different countries are very similar by substance, in fact time and the extent of preparatory efforts which is needed to set up favorable environment for investments, including administrative procedures (starting point) and the kick off of production (final point) may be different in various countries.³⁶⁵ Moreover, in terms of the rapid changes in global trends, intensification of cross border movements of capital, and the expansion of globalization, national legislation as to foreign investments needs to become clearer, more transparent, stable and consistent. This process should equally take into account both international experience and specific domestic conditions to harmonise and improve the legislation bringing it closer to international requirements.³⁶⁶

In this regard, as the development in the past has shown, it still to be a pressing issue in Uzbekistan how to improve the existing laws and undertake, if necessary, some additional measures to fill this lacuna. Almost all the national laws with regard to foreign investors are good enough, if not perfect, since they were developed in compliance with similar norms in more developed economies. The role of the laws in designing the rights and guarantees for foreign investors, however, still remains relatively low. One of the evidence of that view could be comparatively moderate volumes of direct foreign investments into the republic in the last years in comparison with the existing potential, or additional requirements from investors to provide them with government guarantees, regardless of a number of specific national laws rendering much-desired protection.³⁶⁷

³⁶⁵ According to the research conducted, company registration could take place within three days in Latvia, when it usually took more than three months in Slovakia, i.e. without a bribe. Investors in general, or foreign investors in particular complain often that implementation of legislation was inconsistent, unfair, rigid or corrupt. See Coolidge J. *The Art of Attracting FDI in Transition Economies*. The World Bank/William Davidson Institute, Transition, 1999, October.

³⁶⁶ What is learnt from experience is that countries with poor legislation have to face a significant share of the shadow sector, most part of which usually consists of national firms. Developed practices, as a rule, prevent foreign companies from using these deceptive practices putting them in unfavorable condition with shadow sector. Therefore, national legislation must be improved and the aforementioned measures could be seen as a positive step towards the given direction.

³⁶⁷ Among other factors, in 1996 there were 1152 enterprises with foreign investments registered in the republic with total equity capital \$1561 mln., while only 152 in 2000 with equity capital \$83 mln.USD. See: Gulyamov S. *Aktualnye Problemy Razvitiya Zakonodatelstva Respubliki Uzbekistan po Inostrannym Investitsiyam*. Magazine *Obshestvennyye Nauki v Uzbekistane*. 2002, No 2. p.35

The recent policy of the government was based on the principle of a case-by-case approval of investments coming to Uzbekistan through the submission and consideration of the information and documents by investors. On the one hand, it might look like a formal process of collecting necessary data on investors in the country, because the approval of the documents was guaranteed if they were in order. On the other hand, this procedure witnessed about very firm ideas of the government to define directions and profiles of the foreign investments. The package of protections and benefits may only be available for those investments which the government deems to be appropriate. In a fundamental sense then, the current Uzbekistan foreign investment policy seeks to graft selected foreign investment onto the economy in designated industries and offers substantial protections and benefits to the selected foreign joint venture partner.

The foreign investment law contains general guarantees of equal national treatment and further assurances of rights and protections on matters such as expropriation and profits repatriation which are of specific interest to the foreign investor. Among the protections is an assurance that new legislation which would worsen the position of foreign investments will not apply for 10 years after the investment is made (if otherwise, compensation will be made). Further it is provided that foreign investors can choose to adopt more favourable terms of any subsequent legislation.

The foreign investment law has several exclusive provisions for enterprises with foreign investment in relation to rights to import and export and foreign currency arrangements. Their intention appears to be to provide treatment at least as favourable as national treatment. There appears to be only one instance in which the foreign investment law provides less favourable terms than national treatment for enterprises with foreign investment, stipulating that where the chartered fund is not “formed” within a year of registration the company will be deemed to be insolvent.

In modern terms, the foreign investment law thus provides most of the minimum assurances that a foreign investor would expect in relation to national treatment. There are no particularly advantageous provisions for foreign investors in the law, except for the 10-year guarantee against adverse legislative change, which itself is flawed.³⁶⁸ Moreover, an absence of

³⁶⁸ For example, it may not be clear to a prospective foreign investor who seeks to invest through ownership in an Uzbek enterprise whether certain protections, such as those against expropriation and adverse changes in legislation, apply to the enterprise or only to the foreign shareholding. In this regard there may be a distinction between an “enterprise with foreign investment” and other enterprises. By implication, the variation from national treatment does not apply to other enterprises which, although they have some foreign ownership, fall outside the definition of an “enterprise with foreign investment”. These are likely to be smaller enterprises (with a charter capital of under US\$ 150,000) but could also include very large enterprises which have less than 30 per

discriminatory laws may not automatically produce real benefits. The provided “national treatment” is of little comfort to foreign investors when the general standard of treatment of business is regarded as being poor.

Let us consider two guarantees in the law which are in danger of being breached anytime. The first is the guarantee on repatriation of profits which may be caught up in the general foreign exchange difficulties, especially if it took place in history. If foreign exchange restrictions are imposed, then few investments could pay dividends and the guarantees have yet to be put to a sustained test. From the past experience, established foreign investors have revealed that there would be little chance of obtaining the foreign currency required to repatriate dividends.

On the other hand, the 10-year stability provision is well intentioned but problematic for objective reasons. From a government standpoint it is very far reaching. It covers all foreign investments and appears to guarantee stability in relation to all areas of public policy except in relation to matters of national security. This ties the hands of government for a very long time and invites difficulties. Already there have been difficulties with new taxes and increased rates of taxes as established investors claim a right to retain the original arrangements. From an investor standpoint such an assurance is not of bankable value unless it is contained in an agreement with the State. But the government is understandably reluctant to enter into such agreements in all cases. In the event of a dispute with the state there is recourse to national arbitration unless there is an agreement with the state which provides for international arbitration. Naturally, experienced foreign investors will want to have recourse to international arbitration in the event of disputes with the state. Major investors will want to know how willing the government is to enter into agreements with foreign investors which provide for international arbitration and how readily judgements can be enforced.

One of the critical aspects of the given situation to take place is that the laws adopted are apparently more declarative, since they describe the common principles of activities, rather than contain specific and clear mechanisms and the perception of awaited guarantees.³⁶⁹ It also seems to be true that this sort of national laws and their provisions are not regarded as legal norms of direct and immediate influence, when concerning rights and privileges for

cent foreign ownership. Presumably in the latter case it is assumed that the foreign investors are portfolio investors. Prospective investors are unlikely to be clear as to the status of small and medium scale enterprises i.e. those which would not fall within the definition of “enterprises with foreign investment”. For example, is an enterprise with a charter capital of US\$ 100,000 and 100 per cent owned by a foreign investor covered by the guarantee against nationalization or covered by the 10-year stability provision? Or is such an enterprise to be treated exactly as one which is entirely nationally owned? Finally, is the treatment promised in the foreign law being met in practice?

³⁶⁹ Gulyamov S. Aktualnye Problemy Razvitiya Zakonodatelstva Respubliki Uzbekistan po Inostrannym Investitsiyam. Magazine Obshestvennye Nauki v Uzbekistane. 2002, No 2. p.36.

foreign investors. On the contrary, they may embrace a lot of references to the variety of additional legal acts to be adopted on the middle level of power, i.e. by various ministries and state organs, whose decisions are to complement the national laws. In terms of vague definitions provided by national laws, it leaves a space for unnecessary duplication and various interpretation of the legislation by the government authorities on the middle level and foreign investors. In turn, it substantially complicates and reinforces existing internal inconsistencies and discrepancies in legislation.³⁷⁰ Such uncertainty with regard to general environment and to legal conditions in particular could not be seen in compliance with the efforts of the government to make domestic business climate more favorable. Thus, in view of the aforementioned legal spaces, domestic legislation could be potentially apprehended by investors as being more liberal or equally more rigid.

There are at least two ways which may contribute to the clarification and some relief of the situation. If the government wants to keep the right for “worsening domestic investment climate”, as a result of its immediate actions, such as, for instance, introduction of foreign exchange restrictions, higher customs rates, higher social allocations, etc., it could be better if these cases would be represented in the given laws themselves. The alternative to this solutions might favor a provision which would authorize the government to enter directly into the agreements with investors to cover a selected list of issues, such as taxation, foreign exchange and export and import rights, etc. Standard or model terms would be prepared and published as a part of the investment reviews and model contract packages, ensuring thus more stability in local terms.

In these cases, the FDI donors, as well as government bodies, would clearly feel and aware the risks and consequences of the undesired situation, as well as the reasons and way-outs before the investment process had already been under way. All this would provide them with a clear mechanism assisting to avoid potential discrepancies and misunderstanding between the host country’s authorities and those desiring to do business in Uzbekistan relatively potential changes for the worse. The ability of Uzbekistan to offer proactively such arrangements on a transparent and orderly basis would be extremely well regarded by major foreign investors.³⁷¹

³⁷⁰ See also Khamedov A., Atabaev E. O Nekotoryh Aspektah Pravovogo Regima Eksportno Tovarov v Respubliku Uzbekistan . Magazine *Halqaro Munosabatlar*, University of Wolrd Economy and Diplomacy, 2002, No 2; Uzbekistan. Foreign Trade Bariers. US Government Worldwide Country Analysis. See also Report of International Financial Corporation.

³⁷¹ An important step in protecting property rights was made with the government’s decree “On Additional measures designed to protect the rights of FDI” of May 2, 2003. Special departments for legal protection of foreign investments were established in the frame of the federal Ministry of Justice and in all of its subregional

To sum up, the necessary reforms of the legal base need to be pursued within the general framework to embrace further simplification, transparency and stability. In particular, these principles could be strengthened through the implementation of the following primary measures on:

- the encouragement of competition and efficiency with protection being provided to all investors, both domestic and foreign. But, competition and efficiency in the domestic economy could be barely attainable until all the investors would do feel certain about the general local terms regardless of foreign investments are granted national treatment.
- the terms of investments, rights and guarantees for protection which should be clearly defined in national laws. Various references should be eliminated, in order to avoid further discrepancies and misunderstanding in the interpretation of different provisions.
- the creation of a clear mechanism of decision-making and applicability of legal procedures, in order to contribute to the rapid and positive solutions between the parties concerned. Any burdensome actions, bureaucracy and administrative barriers, especially concerning the particular agreements on investments projects should be excluded, since such kind of delays are used to be interpreted by foreigners as additional transaction costs of doing business and making investments.
- transparency of national legislation, including the decisions of government authorities. In other words, investors are keen to know what kind of requirements they are going to meet before the Uzbek legislation and corresponding government agencies. Moreover, stability and consistency in legislation are able to strengthen the given principle.
- appropriate domestic and foreign policies to issue if necessary public statements on the irreversibility of the reforms on liberalization and the commitments to follow these reforms, including to set up favorable business environment.

divisions. The department is commissioned to monitor domestic situation concerning the rights of foreign investments; analyze and make inquiries based on the claims from investors against the actions of state bodies which have led to worsening and breaching the rights of investors; in case of illegal steps of the government authorities, to take actions in favor of investors, including the suspension of ill-grounded decisions in force, appropriate investigation procedures, bringing faulty government officials to administrative punity, etc.; as well as look into the existing situation and work out recommendations for further improvement, and some others. Yet it is relatively early to find out, to which extent the given measure has had a positive impact on the activities of the established investors, as well as on those willing, but still applying a wait-and-see strategy with regards to domestic situation. Obviously it will further depend on, how serious the government is going to be about privatization and the parallel institutional reforms.

- the steady improvement in national laws and correlation with well established principles of international law, i.e. to ultimately provide a legal framework for investment activities within the multilateral system of foreign economic relations.
- the enhancement of foreign investments into the specific areas too. The question is how to improve legislation on using rich domestic mineral base with concomitant steps on restructuring and denationalisation of the mining companies on the one hand, and maintain national interests on the other hand. International experience refers to the examples of countries who managed to suggest investors so called investment contracts in line with the provisions of general legislation, but also specifying priorities and potential of each particular sector. This approach is, for example, widespread in some countries as to mineral and petroleum exploration and development.³⁷² These would also be structured so as to enable the key financial terms, including acquisition value and forms, to be established through a process of competitive bidding.
- complementarity of the reforms. This approach should foresee the measures to improve situation in the banking system; to create conditions for financial markets to function more actively; to expand non-centralized free market auctions and trades of resources and goods on domestic commodity exchanges; as well as the reforms in the administrative and court system. The latter supposed to be particularly important for the mechanism of protection of FDI rights to become viable and palpable in its action.

As the aforementioned measures are undertaken to stimulate more investments, further steps could be justified. Most probably, they could comprise refocusing priorities in line with the global trends, when the requirement to the size of investments are cushioned or set aside at all, in order to allow small and medium enterprises to take more active part in transnationalization processes. Moreover, strict registration procedures and approvals are replaced with simplified rules which may include minimum standard of the requirements common to all economic units.³⁷³ Moreover, further deregulation and decentralization in the foreign economic sector is seen to be also essential, since it suggests more sovereignty and commissions of the regional authorities (khokimiyats) to keep on expanding direct dialogue with foreign investors.

³⁷² For instance, the Latin American countries are vivid examples in this respect. Many of them developed and used specific and detailed system of national laws, such as oil, mountain, and forestry codes, to draw more volumes of foreign capital into the primary sector of domestic economy.

³⁷³ World Investment Report 1999. Foreign Direct Investment and the Challenge of development. UN. N.Y.- Geneva, 1999.

5.2.4. Government Regulation: Where Are The Limits?

To maintain efficient domestic laws are critical in pursuing foreign strategy by a country. However, there is some delicate aspects in the issues related to FDI. The necessary improvements in national legislation aim primarily at the protection of the interests and rights of foreign investors running business in Uzbekistan. But, to make the given process even more consistent and compatible with the national interests in terms of acute competition for FDI worldwide appears to be an uneasy task. Under such circumstances this would require from the government to search for the new approaches and tools in pursuing its policy.

One may be observed, that in the last decades of the world development there has been a common trend towards general liberalization and adoption a number of complementary efforts to draw more volumes of FDI across the world. (Table 5.1)

Table 5.1 Changes in National Regulations of FDI, 1991-2002

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60	63	69	71	70
Number of regulatory changes	82	79	102	110	112	114	151	145	140	150	208	248
of which: more favorable to FDI	80	79	101	108	106	98	135	136	131	147	194	236
less favorable to FDI	2	-	1	2	6	16	16	9	9	3	14	16

Source: UNCTAD World Investment Report 2003. FDI Policies for Development: National and International Perspective.

These shifts towards liberalization were specific and different in their forms over the time. In the end of the 1980s-beg.1990s, substantial steps were undertaken to open national borders to foreign capital, especially in the spheres to be regarded before as strategic ones, such as energy, communications, transport. These processes, which took place in Latin America, for example, were accompanied with large-scale privatisation measures. In terms of poor efficiency of national capital, the “open doors” approach was justified with a view that economic growth in these countries could be provided with the appropriate levels of foreign capital inflows. Facing the decline in FDI inflows, many governments accelerated the liberalization of FDI regimes, with 236 of 248 regulatory changes in 70 countries in 2002 facilitating FDI. Asia is one of the most rapidly liberalizing host regions. An increasing number of countries, including those in Latin America and the Caribbean, are moving beyond

from just dismantling trade barriers to adopting more focused and selective targeting and promotion strategies to foreign investment. Financial incentives and bidding wars for large FDI projects have increased as competition to intensify. Therefore, national policies in the host countries became much more liberal and some encouraging steps were also pursued: legal restrictions on acquiring the shares of national companies by foreign companies were abandoned; while the establishment of joint ventures were fully supported, etc.³⁷⁴

But, it was in the mid-1990s, when the competition for foreign investments had even more intensified, especially after the new recipients from East Europe and the former Soviet Union had come on the arena. Moreover, the needs of the host economies of South and East Asia, as well as South America were also maintained. In these terms, the general concepts and measures on liberalization proved to be insufficient. Countries began resorting to more concrete and targeted encouraging steps, such as the elimination of foreign exchange restrictions, profit repatriation, most-favored nation regime, applying the principle of equality to both domestic and foreign investors, etc, so that to attract more FDI. As domestic policies were providing more FDI flows, the emphasis in the recipients, mainly in less developed countries, was shifted towards more guarantees both to retain existing and enhance further flows in terms of sluggish global investment flows in the beginning of 2000s (see table 5.2).

Table 5.2 Types of Changes in FDI Laws and Regulations (% as of all changes)

	1998	2002
More Promotion	45	36
More Liberal Entry and Operational Conditions	39	31
More Sectoral Liberalization	10	8
More Guarantees	4	20
More Control (restrictions)	2	5

Source: World Investment Reports for 1999 and 2003.

It is a complex task to point at the universal measures, either tax, fiscal or political, which would be equally effective in different countries. One group of experts believe that the most important thing in this way is to improve general domestic business climate through using all available macroeconomic and political instruments, such as maintaining favorable real exchange rate, raise in efficiency of the activities of government bodies, liberalization of foreign trade, etc.³⁷⁵

³⁷⁴ Pavlichenko R. Regulirovaniye Pryamyh Inostrannyh Investitsiy : Tendentsii i Problemy. Magazine *Mirovaya Ekonomika I Mejdunarodnye Otnosheniya*, 2001, No 4.

³⁷⁵ Pomfpret R. Foreign Trade Policy For Economies in Transition. Magazine *Ekonomichskoye Obozreniye*, 1998, August.

General improvements are likely to play a substantial role in giving investors primary information and necessary conditions to evaluate the country's possibilities and therefore, as well as to define its basic investment ratings. In terms of transition economy, however, it is sometimes difficult to use the classical methods of economic regulation and to maintain the much-needed stability in policy tools or actions as to specific priority targets (low inflation, stability in exchange rate, efficient financial infrastructure, etc.). Then, additional steps from the government seem to be important. This choice among the available measures, however, again may be hidden between their efficiency in reaching the goals, and the local capabilities, facilities, and political will to realize them. For example, costs of liberalization to be caused by the concessions for investments might be compensated through the achievements of the desired results.

In this context, possible costs and the limits of available instruments may be of quite relevance. Financial incentives for foreign investors are directly related to the expenses of state budget, accompanied with the risk that the given measures would be fully and effectively put into effect. Tax incentives, on the contrary, do not require immediate costs and come into force only when the investment project is completed and ready for practical realization. Improving domestic infrastructure facilities (transport, communications) is not a targeted measure, since it does not make a difference between domestic and foreign investors, all parties will have access to them. What is also important in using the given instruments is that the choice is going to be dependent on the general national strategy the country follows. For instance, it is well-known that open South East Asia was principally better in applying variety of tools, such as tax rebates, duty drawbacks, tax and duty exemptions, than Latin American autarky economies not the least due to the general line in foreign economic relations.

On the other hand, one needs to emphasize that general trend in world development is that government retains regulation over FDI in almost all countries. Despite the magnitude of bi- and multilateral agreements on free access to host countries' markets, no agreement denied the control over FDI inflows.³⁷⁶ In Uzbekistan, the national policy is due to shift its priorities from strong government intervention in the past to modest and justified government control in the years to come. *"We have to recognize that the government is actually still maintaining its too high influence in the domestic economy. It is reflected, first of all, in the existence of the still high number of enterprises to contain the state assets; in the high stake of the government in equity capital of the privatized enterprises; in the conservative mechanism of government regulation; and sometimes also in the direct intervention from the government into the*

³⁷⁶ See more details in UNCTAD, Document N TD/B/com.2/EM/6/2, 1999.

activities of economic units... We need to eliminate the half-way reforms, and to reinforce the role of private sector in the domestic economy, as a primary task ", was emphasized by the President of Uzbekistan.³⁷⁷

In this regard, some questions may be taken up: where are thus the bounds for the government, in order not to contravene property rights and equally to stand for the defence of strategic national interests? What is the substance of this policy going to be and which particular aspects should it comprise?

In terms of general liberalization with the two key elements, such as the elimination of barriers and the principle of national treatment with FDI, the role of government would likely need to be present. This approach could be supported for some reasons. It is clear that in terms of a transition economy, loosening domestic conditions and domestic markets may have to face with other limitations set up not by the government, but by the economic units, in particular by large monopolist companies. The crowding-out effect may take place, when national firms undergo severe pressure from such large foreign economic units. Such undesired effects may happen in different forms. The one may develop in domestic markets of goods, the other one - in financial markets. As a result of the privileges provided by national legislation, as well as objectively due to the much stronger position and capacities, these companies would acquire large shares and domestic resources and therefore, depriving or diminishing opportunities for local firms.

Besides, the strategic priority of any government is the interests of national business and industries. In the given situation, when national producers are basically poor-prepared and extremely vulnerable to external forces, it is the government which is the only efficient and strong party to resist any potential negative tendencies. The task of the government is to find what is called as the golden mean between the development of competition and stand against the monopolisation of domestic markets. Moreover, a small open economy, like Uzbekistan, is very vulnerable to abrupt changes because of capital flows in both directions. It requires to monitor domestic situation with balance of payments and to take appropriate measures, if it is under long-lasting and regular pressure. If so, the steps of the government to regulate foreign loans of domestic branches of foreign transnational corporations, transfer pricing, etc. appears to be justified, in order to subsequently avoid domestic macroeconomic imbalance.³⁷⁸

³⁷⁷ Translated from the speech of the President of Uzbekistan Karimov I. made at the meeting of the Cabinet of Ministers devoted to the outcomes of socio-economic developments in the country in the year 2002.
<http://www.press-service.uz/rus/rechi/r02172003.htm>.

³⁷⁸ See Transfer Pricing. UNCTAD, N.Y. - Geneva, 1999

The aforementioned steps, however, should not damage the encouragement of competitive environment which seems to be equally a desired and hard task. The transition economies, as a rule, may not have either sufficient experience or effective organizational structures to maintain efficient local conditions for competition, as foreign investors can. In Uzbekistan, an issue of competition is affected, to some extent, by the constraints on foreign capital inflows, as well as by the focus on large-scale investors with the lowest prioritization of the small ones involved in trade and services. One of the important factor which may contribute to the solution of the problem, could be the principle of supporting not only large-scale, but also small-scale inflows. Such businesses include a variety of office support services, import and export facilitation services, industrial maintenance and supply businesses, technical services and so on. Such a network of effective support services is very important to prospective investors, including large investments. The true lies somewhere in-between and costs and benefits of the extent of government control will also depend on the contribution, both current and potential, from local and foreign sources, to be made by large-scale enterprises and the small and medium-sized sector.

Environment protection is expected to be another aspect of government regulation. Since the authorities of host countries are dealing with a wide range of investors differed from each other by the field of activities, the character and form of production, priorities of business, etc., some contradictory views have been established in the world as to the actions of foreign investors abroad. Some investors come under the pressure, since they appear to deliberately use the environmental issue to transfer "dirty industries and technologies" to the third countries where environmental requirements seem to be less rigid, regardless of adequate economic and political conditions. The other group of investors, on the contrary, are distinct with much higher corporate requirements to meet environmental standards.³⁷⁹ The logical move in the policy direction in Uzbekistan urges to be equally liberal towards foreign capital, and also rigid to the extent, to which necessary steps to improve national legislation on environment are needed. Yet net benefits, both political and economic, are still to be counted in terms of competitiveness and the impact of national ecological problems on the extent of FDI flows.

The growing share of foreign investment capital is more concerned with mergers and acquisitions and to a less degree with setting up new production facilities, or so called "greenfield facilities" relying on short-term and easily attainable returns on the capital

³⁷⁹ Pavlichenko R. Regulirovaniye Pryamyh Inostrannyh Investitsiy : Tendentsii i Problemy. Magazine *Mirovaya Ekonomika I Mejdunaodnye Otnosheniya*, 2001, No 4.

invested. Yet when FDI takes the form of "greenfield investment", it represents a net addition to the host country's capital stock, while FDI entry via an acquisition may not represent any addition at all to the capital stock, output or employment. Moreover, the latter often reduce competition in the domestic market and may lead to an increase in the market power of transnational corporations. Experience shows that in the economies of Central and Eastern Europe, it was privatization of existing real assets which was the most often used and significant form of FDI attraction. But this kind of attraction promoted FDI mostly in activities with low-export intensity, such as communication, energy, banking and insurance which, in a row of positive effects, also finally put the countries' balance of payments under pressure. Some of those governments found themselves between the devil and the deep sea, when rushing to privatization with FDI and agreeing to many years of monopoly protection, became then required by the WTO or the EU to renegotiate the deals and allow more competition.³⁸⁰

In this context, domestic policy in Uzbekistan is surely expected to follow long-term goals by encouraging more greenfield capital investments to back up export-oriented growth. Yet, Uzbekistan is to confront with the two particular problems in this case too. The first one is that the government was and is still trying to sell old state assets, especially a great deal of unfinished factories, including those left over from the Soviet times. But they represent little interests for potential investors. Moreover, the policy had difficulties to suggest the appropriate mechanisms of assets evaluation which is not going to be a major impediment to the sales of existing assets, but consequently may stall investors from greenfield projects too.

The second one directly touches upon a problem of the public officials' expertise. It may really reflect one of the primary concerns in transition, since it implies a shift from one socio-political and economic system towards which are fundamentally different by substance. There are both elements of objectivism and subjectivism in the given process, when the relevant state bodies turn out to fall behind full-embracing political ideas and decisions or simply reluctant to continue with the reforms. One can find a lot of debates on these issues within the government itself. Almost every large speech of the President of Uzbekistan, regardless the sphere of the domestic reforms, reflects regular statements and critical points as to specific state bodies both on the national and regional levels. For instance, at the one of the government meetings in 2003, he was especially critical about the Goskomimushestvo, a responsible government authority for national privatization campaign, for its inflexibility and

³⁸⁰ The Art of Attracting FDI in Transition Economies. The World Bank/William Davidson Institute, Transition, 1999, october.

holding up investments: *“It is necessary to stress that the Committee (Goskomimushestvo) does not fulfill its functions to the full manner so far. There is no clear common efforts in the work of its regional subdivisions. The Central Apparatus and its regional divisions, as the recent attestation has shown, is badly provided with a competent staff. There is still many “casual” people who have poor imagination about the tasks of the Goskomimushestvo”*.³⁸¹

Consequently, the possible ways out be partly found in administrative reforms.³⁸² It is not going to be a process of formal reduction in number of government officials. It brings little, if the old style of work and methods of management remain. *“First of all, the managerial set-ups on different levels must be freed from the out-dated functions which were intrinsic to the old administrative-command system of distribution. If there would be no such functions, then there would be no needs for officials which supposed to accomplish these functions. They would be aware that their time has gone, that new approaches, other methods, other tools of management would be required. It must be modern market mechanisms, economic leverages and incentives which should come to replace the shouts, the administrative pressure and voluntarist decisions, the rights to allocate government resources according to the old principle “it is up to me to decide what and how much you will receive”*.³⁸³ It certainly implies that this reform is going to bring the new principles of behaviour into the various spheres, such as access to necessary resources not through distribution from the government, but via free and open market and fair and auction trade.

Finally, what is important is to see and tackle the problems in a complex way. For example, although domestic tax rates have been facing an annual decline in the recent past, the tax burden still remains relatively high, due to taxes on employers, high payments to social funds, etc. In turn, this affects production efficiency through higher labor costs and hence puts the country in less competitive position comparing to other countries.³⁸⁴ However, the reform in

³⁸¹ Translated from the speech of the President of Uzbekistan Karimov I. delivered at the annual meeting of the Cabinet of Ministers on the socio-economic developments in the country in the first half of 2003. Newspaper “Narodnoye Slovo”, 19 July 2003.

³⁸² See more in the next subchapter.

³⁸³ Translated from the speech of the President of Uzbekistan Karimov I. delivered at the meeting of the Cabinet of Ministers devoted to the outcome of socio-economic developments in the country in 2003 on 7 February 2004. <http://www.press-service.uz/rus/rechi/rechi.htm>.

³⁸⁴ It is important to restore coherence and stability to Uzbekistan’s tax policy. The tax regime should be fair, transparent and consistently administered. Above all, the Uzbek tax regime should be no more burdensome than that of neighbouring countries. There is no strong evidence internationally that frequent announcements of concessions encourage new investment (and even less so when there is a history of unforeseen new taxes). Investors will be more impressed by an attractive and stable tax regime which encourages new investment by reducing the early burden on cash flow and which is structured so as to tax profits rather than turnover or assets. Among such measures, could be seen, for example, accelerated capital allowances for investment; removal the restrictions on deductibility of capital allowances and on losses carried forward, as well as on the petty and unnecessary restrictions on deductions for labour costs, entertaining and advertising.

the given field, for instance, does not concern the reforms in the tax sphere only. It signifies the adequate steps in social policies, the improvement of the pension system through the development of the other forms of pension funds in addition to state ones, and the subsequent reduction of pressure on state budget. In turn, these measures will require sustainable development of financial and investment markets, insurance companies, banking system, etc. which are expected to promote the real sector doing better, as well as encourage more foreign capital.

5.2.5. Domestic Policy Coherence

In a row with the logics of the debates on efficient government policies as to FDI, the better coordination and policy coherence between domestic government agencies are called to play a significant role too.

All previous efforts of the government have shown its evident desire to attract FDI to Uzbekistan. This is apparent from lack of legal restrictions on foreign investment, the commitment of senior government figures to promoting Uzbekistan abroad and the well-meaning fiscal incentives that are made available. The priorities of the government are to attract private investment to export-oriented and import-substitution industries and special importance is placed on investments that introduce advanced technologies and/or pioneer new industries.

The results have been mixed so far, and there is strong evidence that individual policies either failed to support the government's objectives or in some cases actually worked against these objectives. For instance, the objective of attracting foreign investment is, to an undue extent, attenuated by the government's own caution towards private investment and the market economy principles. This was manifested in policies which had retained a large commercial role for ministries and State enterprises and regulatory practices which were highly intrusive in normal business transactions such as imports. It was also seen in the government's indifference to small and medium scale in trade and services in favor to large strategic investors. Another example could be seen in tough foreign exchange and trade policies in the recent past.

The large role of the specific Ministries in the country reflected controversial impacts on the fulfillment of the government strategy with regards to foreign inflows. Nowadays the high level of government role which the prospective investors have to face at any way persists with the key coordinating role is undertaken by the Ministry of Foreign Economic Relations whose role was inherited by the Agency for Foreign Economic Relations established in 2002.

Investors will deal extensively with the relevant line ministry (which may have commercial as well as regulatory functions) and with the State Committee for State Property and Development of Entrepreneurship (GKI) when State asset sales are involved. The semi-public Foreign Investment Agency is playing a facilitating role which concerns the issues of searching potential Uzbek partners for prospective foreign investors, as well as gathering general information on local investment conditions which may be of interest for the comers. The Ministry of Justice and its divisions are going to serve mainly for registration procedures. Thus, significant prospective investors do receive extensive high-level political attention, including a meeting with the President and any other high government officials concerned.

On the other hand, there was simply lack of coordination between government bodies which had led to undue losses of time for investors to get through all registration procedures, negotiations of particular rules, and to gain much-expected approval for making investment, although quite the contrary is required in this case. Moreover, some interviews of investors also believe that these processes were very much complicated by the centralization of decision-making when “there were only one or two decision-makers in the entire government”, also paradoxically the low relegation of power fosters a top overloaded echelon of the persons in charge.³⁸⁵

In such situation, foreign investors may contact and see these government bodies not as equal and sovereign management partners, but as an intermediary link to the central government which eventually proved to be the key authority to address by substance the whole range of issues between investors and local bodies. It may witness not only about a little degree of sovereignty of each separate organ at the middle level in passing resolutions which may benefit them. It may be also a sign of high role of the government in the economy, low level of privatization, as well as a firm view and desire of the government strategy to negotiate every aspect and profile of foreign investments by scope and sectors of the economy.

In present conditions, however, more flexible approach is needed to ensure efficiency with regards to both the quality of domestic policy measures and the bodies which normally undertake them in the context of the declared liberalization in economic activities. It primarily concerns the *administrative reforms* in Uzbekistan.

³⁸⁵ The Ministry of Justice, for example, is liable for registration of foreign investment projects up to \$20 mln.US. Foreign injections of higher volumes are to be enrolled with the approval of the Cabinet of Ministers only. See: Investment Policy Review of Uzbekistan. UNCTAD, 1999.<http://www.unctad.org/en/docs/poiteiipm13.en.pdf>

“The time is ripe for the reforms in the administrative system and we can not put them off. In their absence, it becomes not simply complicated, but impossible at all to conduct deep economic transformation”, according to the President of Uzbekistan I.Karimov.³⁸⁶

In this regard, there appears to be at least two significant rationales. On the one hand, it concerns the activities of the line Ministries and state bodies. For the recent years, many of such state organs have been changed in their forms of ownership in favor to various concerns, corporations, associations, etc. Yet in principle little of them have denied administrative spirit of management and, therefore in most cases they still retain highly intrusive ways of influence on economic units. The primary question lies in rationalization of relations between respective state agencies and economic units involved in each single economic area. The latter should become not only duly independent in their economic activities, but also actively involved, in cases of associations and unions, into the decision-making process and conduct real management over the administrative boards of such set-ups. This will be much dependent on the process of attracting necessary volumes of foreign investments which are expected to bring not only much-needed funds, but also modern and democratic values in administration of each particular enterprise and relevant unions of such enterprises in general. The inflow of investments would be also strengthened by the fact that many state agencies have retained lots of assets, especially non-working assets, which heavily affect their and budget funds. The large-scale privatization and selling-offs of these assets to foreign investors is clearly a top line in the adopted programme of privatization in the years to come.

On the other hand, nowadays many line state agencies are responsible for realization of the decisions of the higher administrative level in government machinery. In such cases, they virtually immediately depend on the central government with consequently little initiatives at middle level. In perspective, however, these agencies should be more active to the sense, they would become equally more authorized and liable and willing for the job and projects, as well as for the decisions concerning each particular sphere adopted and realized at the middle level. This would also allow them to concentrate more on closer coordination of relations with the units and their existing problems, seeking for common solutions and developing general forecasts on further progress in the relevant industries. The development of closer horizontal linkages between the Ministries and state bodies would be also extremely crucial to make up common national strategy in relation to foreign investments. Their common efforts could

³⁸⁶ Translated from the speech of the President of Uzbekistan Karimov I. delivered at the annual meeting of the Cabinet of Ministers on the socio-economic developments in the country in the first half of 2003. Newspaper “Narodnoye Slovo”, 19 July 2003.

become in this respect something very necessary and positive to form even clearer vision of openness and predictability in the eyes of future FDI flows.

The aforementioned processes could be given an additional impulse, if they would be complemented by the decentralization of decision-making and the enhancement of more economic power and commitments on the regional level too. It would embrace the transfer of some functions and responsibilities to local authorities, as well as the similar abolishment of unnecessary set-ups and stages in the administration system. The role and liabilities of the local municipalities are expected to increase in almost all aspects of socio-political and economic development in the republic. The case of such power transfer and efficient relations between the state and private sector could be seen during the establishment of free economic areas in the different parts of Uzbekistan.³⁸⁷

But what is crucial in this respect is that these changes should be real, with the avoidance of shallow practices, in order to bring efficiency into the whole system of state administration. *“It is of high significance to adhere to the principles of a market economy. Otherwise, this [centralized administrative control] would have not been eliminated, but a simple transfer of administrative regulation to the lower structures of the power system would have occurred”*.³⁸⁸

The problems to be encountered by prospective investors in obtaining clearance to invest have led to suggestions that more *administrative coordination* is also needed among the agencies which deal with the requirements of investors. In some countries this has led to the creation of the “one stop shop” foreign investor agency which is meant to handle the entire investment entry process. This approach is unrealistic as a single agency is unlikely to have all the skills, or be surrendered the necessary clout by the line ministries, to take over all the responsibility.

It is of fundamental importance that the Agency for Foreign Investments takes the lead in ensuring that the foreign investment dimension of recommended reforms be taken fully into account. The Agency could be more proactive in working with the line ministries as well as ensuring that the foreign investment community is consulted as policy is developed.

Certainly, one does not recommend significant change in the government machinery for dealing with particularly investment entry procedures. The largest pay-off will come from standardizing the treatment of investment terms through better policy development so as to

³⁸⁷ This issue is considered further.

³⁸⁸ Translated from the speech of the President of Uzbekistan Karimov I. delivered at the annual meeting of the Cabinet of Ministers on the socio-economic developments in the country in the first half of 2003. Newspaper “Narodnoye Slovo”, 19 July 2003.

reduce the range of issues requiring individual attention and negotiation and to provide clear policy benchmarks for government agencies in their dealings with foreign investors. There is a need to clarify and focus the roles of individual agencies with the government machinery.

At present all significant FDI is subject to an additional stage of approval over and above the regulatory and other approvals and agreements pertinent to its industry. This additional stage (sometimes described as “one more shop”) has not itself been the source of delays and frustration felt by foreign investors with the entry process. This suggests that the difficulties are principally the result of a lacuna in policy at the industry level and in the process of setting the terms and conditions for investment.

However, the current ground for the government is to reconsider whether it is useful to continue with this registration procedure. If the government wishes to retain a mechanism to block foreign takeovers of existing Uzbek enterprises then there is a rationale for this device. But the rationale is not explicit and the registration procedure is ostensibly a quite formal documentary process. It would be helpful to intending foreign investors to know at the outset through reference to a government policy statement the circumstances in which FDI would not be welcomed.

5.2.6. Foreign Investment Policy Statement

Since Uzbekistan placed a strong emphasis on case-by-case approach in dealing with foreign investments, especially with the large ones, foreign investment policy was flexible within the existing legislation. In present conditions, however, if the reforms the government has committed to follow, need to be carried through, it would be useful to prepare a Foreign Investment Policy Statement of clarity and vision which sets out its national objectives, priorities and applicable terms in a manner which has a strong resonance with investors.³⁸⁹ Then, it should be a key part of the mission of the Foreign Investment Agency to draft this Statement based on its close involvement with the industry investment reviews and the tax and regulatory reforms. Broadly speaking, this institution should play more important future role in order to contribute a foreign investor dimension to economic and commercial policy development within the government.

The policy statements would, for each industry or a sector, take into account and settle the various ministries’ views and interests in line with government objectives. They will set out authoritative and standardized terms and conditions for investment in each industry. If well

³⁸⁹ Developed and proposed by the UNCTAD. See: Investment Policy Review of Uzbekistan. UNCTAD, 1999. <http://www.unctad.org/en/docs/poiteipm13.en.pdf>

prepared they would be of major benefit in smoothing the entry process, both for current and future investors. In other words, it would allow to set out domestic interests in a clearer way to foreign investors, while bringing forward the opportunities for discussions on the requirements of the latter with the government.

The issues to be covered in such investment policy statements could include:

- statement of government objectives;
- fiscal arrangements, including special features, if any, applicable to the sector;
- foreign exchange arrangements, including special features, if any, applicable to the sector;
- the regulatory framework for the industry;
- investment terms applicable to foreign investors, including:
 - particular rights and protections available with reference to the sector;
 - management control and shareholder relationships in joint ventures;
 - exit provisions;
 - the mechanisms for achieving government objectives (forbid unacceptable terms or encourage desirable outcomes);
- operating terms, including:
 - rights to export and import;
 - access terms for key inputs, including land and utilities, and freedom to buy outside the state sector;
 - employment and social obligations.

Yet, comprehensive investment promotion campaign will not achieve its goals, if it is insulated from more urgent steps to resolve some general problems encountered by established and prospective foreign investors (see Box 5.1).

Box 5.1. What is the investors' feeling on domestic policy?

In December 1997, the Trade and Investment Committee of the American Chamber of Commerce in Uzbekistan undertook a survey amongst its members, aimed at documenting the daily operating problems faced by foreign firms currently operating in Uzbekistan, so as to be in a better position to apprise the Government of Uzbekistan of the concerns raised by the foreign business community. The survey, published in February 1998, identified several areas of immediate concern:

1. Currency convertibility and exchange regulations
2. Import contract registration
3. Restrictions on the use of funds in local bank accounts
4. Business registration and licensing
5. Bureaucratic culture and reprisals
6. Customs delays; and
7. Currency surrender requirements.

In addition, the survey highlighted some industry-specific concerns related to insurance laws, rules and restrictions; taxes; and barriers to investment in the natural resources sector.

Source: Investment Policy Review of Uzbekistan. UNCTAD, 1999

Letting aside the debates on the extent of the latest steps in Uzbekistan to address each particular problem, the two implications for national policy can be drawn from this research. The first one concerns investors: despite of the proliferation of the fiscal and other types of the privileges provided by the legislation in order to cushion shortages in domestic policies, investors would rather prefer to operate in generally improved conditions, with less uncertainty and restrictions of any kind. The second one touches upon the government. The past development resulted in some controvercies of using such restrictions in order to prioritize both the coming investments and the development of the specific domestic areas. It seems to be an excessive burden not only for investors, but for the government itself to follow such a strategy in view of complicated and ever-changing legislation, lingering decision-making, administrative and technical impediments. This inevitably makes difficult and slows down investment process, and may quite easily lead to inconsistent treatment among investors, as well as to a perceived lack of transparency while setting investment terms. Moreover, the record of benefits and costs of this strategy would depend not only on the contributions of already established investors in response to legislative and fiscal incentives, but also would comprise those deterred from investing into the economy of the republic in the past years. Although it is an uneasy task to make acute estimates now, one may suggest that Uzbekistan has been underperforming in the area of FDI so far comparatively to its investment potential. In such case, further liberalization and institutional reforms could be very helpful and necessary.

5.2.7. Promotion Campaign, or Information Component in National Investment Strategy

More active efforts on liberalization of FDI regulation in the world have granted transnational corporations with the diversified set of locations to move their funds. As a result, they become even more exacting to evaluate investment climate in the host countries. As competition intensifies, it is already insufficient to focus on liberal foreign policies making the use of various additional privileges only. The picture may become more complete, when the role of information is cordially reviewed nowadays.

According to the established international views, in order to attract FDI many countries need to create good image of a favorable place for the realisation of investment projects. It would

be similar to specifying its place on the map available to foreign investors.³⁹⁰ As a young country, Uzbekistan is also in need for a broad and in-depth PR campaign to make the world community familiar with both domestic and regional developments. In the last decade, sustainable work has been already done to give general information about socio-political and economic events in the republic, either particular and detailed picture of the changes in spheres of social and political life (legislation, administrative reforms, foreign policies, etc.); areas of national economy (mineral base, the structure of the economy, infrastructure, denationalization and privatization, etc.). Besides, a lot of information has been dealing with rich cultural heritage, spiritual life, cultural events of international significance which has allowed to understand local standard of life, domestic traditions, social relations and their integrity with socio-economic developments in the republic.³⁹¹

Generally, however, investment promotion efforts were sometimes offset by poor support with the presentation of highly focused and tightly structured investment opportunities. Investment promotion became reactive once initial positive contact had been made. The Foreign Investment Agency, for instance, was dedicated to facilitating foreign direct investment but its actual contribution remained insignificant in supporting foreign investors to overcome the daunting policy weaknesses to be in place in the local investment climate.

The investment promotion literature is still to be improved, especially taking into account latest changes in general regime and specific areas. A number of published investment guides by government agencies should be in principle helpful but must be regularly updated and improved, both in conceptual and language perspective, to meet international standards. Major internationally recognized consulting companies are also little involved in publishing business guides for Uzbekistan without which the country's chances are slim to be regarded as an equal partner in joint projects.

Simultaneously, to establish a good view on a country is not apparently to be monotonic. It is influenced by exogenous factors too. In particular, investors may have information prepared by internationally recognized consulting agencies, international financial institutions, NGO, which are used to look into domestic trends, conduct analyses resulting in a wide range of

³⁹⁰ World Investment Report 1999, UN, p.182

³⁹¹ Nowadays investment campaign continues to be widespread at a high level within the government. The President and top economic officials, both from the government and from the line ministries, travel overseas regularly to meet investor groups and make themselves available to meet business delegations visiting Uzbekistan. The investor conferences held abroad and the organized visits to Uzbekistan by business delegations are well attended and well received due to the high level support they receive within the government. These events are used to expose prospective investors to broad opportunities and those investors which show interest in major or innovative projects receive ongoing encouragement from senior government figures.

reports. These reports, as a rule, are exacting and relatively tough, especially when the issue of international investments is under consideration. Moreover, they comprise almost all the spheres, including political, economic, social which expands the set of factors to influence investment criteria.³⁹² Complex relations with multilateral donors and financial institutions in the past have likely formed above all a discrepant view on the happening in the country.

On the other hand, it is an accomplished fact that the military operation in Afghanistan in 2001 has forced to reconsider the role of the region in contemporary international relations and therefore, the reinforced formation of new dimensions of global security and common efforts against the global threats. Since then, information on Central Asia in Western mass media has been mainly dominated by analyses and reports on the fight against terrorism and drug trafficking as well as national and regional political developments, including the issues of regional security. *"It is well-known that foreign investments are not used to confine themselves to the needs for (proper) legislative basis only. They come to those countries where there are real conditions to run business; where social and political stability is provided; where political threats are minimal; where there are no national and civil friction. One may set up exclusively favorable legislative base, pass through the most advanced laws in order to reform economy and to draw attention of foreign investors. However, without social stability, without guarantees against political shocks, civil wars and regional conflicts, it would make no sense to talk about the efficiency of the laws in force, about foreign investments inflows to be so much-needed to pursue structural changes in the domestic economy"*, noted the President of Uzbekistan I.Karimov.³⁹³

In this context, without political stability it looks hard to achieve sustainable socio-economic prosperity, conduct ambitious market reforms, make the efficient use of natural resources, improve infrastructure, etc. It is also true, however, that with the acute economic challenges on the agenda, political development, as well as stability and security in each of these countries are a tough task. On the way towards regional stability via the expansion of contacts within and beyond the region at all levels, it becomes high time to use the opportunity for the closer contacts between potential investors and domestic economic units in the light of numerous foreign visits to the region since September 11. It is efficient in that when investors

³⁹² Relatively poor investment ratings concern both general conditions and situation in separate fields. Thus, for instance, as of June 2002, Business Environment Risk Index (BERI) ranked Uzbekistan as the 39 riskiest place in the world. The country was considered to be 114, according to country bonus ratings in 2002. In view of the underdevelopment of domestic financial markets and their poor linkages to the global financial system, almost all countries of Central Asia are either in the group of heightened risk or are not comprised by the analyses at all. More details see in Laenderanalyse Kasachstan/Usbekistan, FAZ, Institut fuer Management, Markt- und Medieninformationen GmbH., 2002, juni.

³⁹³ Translated by the author from Karimov I. O'zbekiston Buyuk Kelajak Sari. Tashkent, 1998. p.651.

come in Uzbekistan, they are able to witness local conditions by themselves, so that to subsequently set up preliminary business linkages.

Uzbekistan has its own views on domestic socio-political and economic transformation processes. In the country the government is commissioned to decide on the main priorities and scale of reforms in all spheres of life. International practice shows a variety of approaches in this regard too. Economic policies of the South-East Asian countries, for example, followed the path of national sovereignty in policy-making, with the preferences of unilateral over multilateral liberalization in order to maintain scope for policy manoeuvring. The Central and Eastern Europe, on the contrary, accepted international commitments by virtue of acceding to supranational bodies and multilateral treaties.

But, what is crucial is that the world is changing towards strengthened globalization on the one hand, and intensified competition on the other hand. That signifies for Uzbekistan to reinforce cooperation with the world community through the exchange of useful information on the country in both directions. Such a collaborative approach, in particular in the information field, can be realized through the efficient linkages with foreign and international analytical agencies which may share methodological and technical experience in turning over the generally accepted methods and tools of analyses. Other important steps may include obtaining sufficient statistical information from relevant state bodies; activation of mass media, encouragement of NGO, etc. In other words, all the aforementioned might be very helpful to bring fresh and updated information into international credit ratings, and, eliminate existing divergencies in evaluations.³⁹⁴ Eventually, it would also assist in persuading investors of the untapped domestic economic potential.

Additional crucial steps to facilitate a trust-building process as to the reforms undertaken may be related to the more openness and transparency of the government bodies. This would imply, as we believe, not only broader access to statistical data, but also more active efforts on arranging official briefings and meetings with the representatives of foreign companies, diplomatic corps, international financial institutions, and mass media as well. The latter, as an integral attribute of modern democratic society, is regarded as an efficient source to propagate relevant information throughout the wide range of circles in space and time.

In the given context, it is also important to increase the role played by high- and middle-rank government officials to take more active and immediate part in explaining publicly the

³⁹⁴ Nadyrkhonov U. Privlecheniye Inostrannyh Unvestitsiy i Integratsionnye Aspekty „Public Relations“. *Uzbekistanskiy Gumanitarniy Jurnal* magazine, 2003, No 1.

government position on various measures concerning investors; in taking questions and giving personal assessments and comments; as well as in the scrutiny of the proposals and recommendations from foreign participants. By holding such meetings on the regular basis the mutually advantageous exchange of views and information between the state and foreign and domestic business may be achieved. This in turn could contribute to the definition and timely elimination of the state policy gaps as well as prevent such deficiencies in the future.

Besides, consistent and closer inter-committee collaboration between the key government agencies will be required. It is also possible, for example, to stimulate set-ups of public coordination councils which might include famed politicians, leading economists, representatives of political parties, as well as regional governors (khokims), mass media, foreign diplomats and international experts. Such structures could hold discussion clubs and round-tables on the challenges of domestic and foreign business whose final decisions and recommendations to improve investment climate in Uzbekistan could make up the foundation for corresponding government decisions. Such experience was widespread in the outward-oriented economies of Japan and Malaysia, and contributed to the development of mutually beneficial links between both domestic private sector and foreign investors and government authorities as well as subsequently ensured successful realization of many government decisions concerning vital long-run economic and political issues.³⁹⁵

In other words, it may allow to improve coordination between the state and private sectors on mutual confidence-building which seems to be an essential element during the transition period to raise the efficiency of a state machine and its policies. In addition, foreign investors are more experienced in using their own capital resources than domestic producers. The latter have had limited capacities for the access to the world markets for decades of historical development and, therefore, unable to adequately behave in market conditions so far. For that reason, there is a strong need for adequate domestic environment for foreign companies which are very sensitive to any steps of the government and thus, able to compare business climate in different countries, so that to choose between the most promising ones. Besides, due to their worldwide network and contacts, successful foreign investors may serve as intermediaries to enhance extra financial inflows in Uzbekistan too.

In sum, favorable investment climate for FDI is critical in which some role is assigned to information campaign too to reach this goal. Relatively tough assessments in international reports, as a rule, look both fair and exacting at the same time. Yet, they need not to be seen

³⁹⁵ Alimov A., Muminov R. Liberalizatsiya Vneshneekonomichskoy Deyatelnosti (Mirovoy Opyt i Problemy Uzbekistana). Magazine *Rynok, Dengi, Kredit*, 2000, No 11.

as final, but as attributable to the specific stage of development only. The foreign policy priority of Uzbekistan places a clear emphasis on the moves towards more sustainable integration with the world community, with domestic progress to have been already made and further plans on the irreversible market reforms. Hence, the role of information is augmented through openness, availability and transparency to highlight domestic achievements. In practice, the main among these steps would signify the following: collaboration of state agencies with corresponding international analytical institutions on the methodological and technical basis; the reforms in the national accounts system; administrative reform, which above all, will imply the new role of state agencies and public officials in arranging efficiently various meetings, round tables, etc. in order to exchange views with private sector (investors, international experts, mass media, NGO); more consistency and coordination between the state bodies in decision-making and elaboration of the common strategy as to investors. In many respects, the expertise of foreign investors could become useful, and contribute to the reinforcement of positive investment image of Uzbekistan on the international arena.

The task of the government policy is not only to eliminate technical, bureaucratic and other administrative barriers on the way of foreign investments, but also to conceive and expand the role of information through conducting and using consequent information strategy with the help of its own institutions, both domestically and abroad. The capacities of mass media, foreign investors, international organizations could be also quite helpful. It is equally useful to follow and monitor the domestic situation in other countries, not only in those which are the main sources of foreign investments, but also in those which are the largest recipients of such resources. Hence, the republic has to sustain severe competition with these countries to attract international investments.

5.3. Free Economic Zones

Another important element is to set up free economic areas which could complement overall foreign economic strategy of the republic in the forthcoming years too.

Free economic areas could be defined as the specific economic territories with particularly favorable investment climate to pursue efficient and targeted individual and production activities. In addition, it is the place, where the interests of both private sector and the government go together in order to reach common goals and advantages.

The given direction is essential in terms of Uzbekistan for the following primary reasons. Such specific areas, as a rule, are established with the purposes to attract more investment, mainly foreign, which especially need friendly treatment to be convinced of the attractiveness

of Uzbekistan as the right place to do business. In the past, foreign capital was usually attracted into the republic mainly by using government guarantees and establishing joint ventures. Yet, in the light of liberalized foreign economic relations, it is crucial to accelerate this process through the broader use of the available tools and opportunities.

On the other hand, free economic zones need to be seen as a complementary instrument to develop and bring into action the national strategy of export promotion. The fundamental objective of export promotion is to prevent a policy-induced bias against exportable products. The ideal way to achieve a balanced incentive system would be to eliminate tariffs as well as quantitative restrictions on all imports and exports and to keep the exchange rate at the purchasing power parity of the national currency. This can hardly happen in view of the government priorities to protect domestic industries and markets for strategic and priority reasons or even on healthy and environmental grounds. In this case, pushing forward and maintaining free economic areas and export zones could be one of the measures to cushion general setbacks in the national strategy.

Moreover, under particular conditions, they also allow the country to benefit from scientific and technological achievements in forms of modern equipment, ways and the methods of production. Finally, as many countries, Uzbekistan embraces the administrative and territorial territories which differ from each other by the level of socio-economic development. In such conditions, it requires from the government to balance national development, i.e. the regions with objectively less favorable local economic and social conditions need some support to keep the pace of general development. In this context, the task of the government is seen in designing a specific atmosphere in order to promote efficient involvement and put into action all the opportunities the given regions. It finally could ensure the improvement not only in the economic structure of domestic economy, but also may be instrumental in addressing a wider number of social tasks too (higher employment, raises in income, infrastructure development, etc.). This, in turn, is about to encourage consolidating the economic roots of secure and sustainable development of the society.

It needs to be mentioned that free economic zones are to some degree, a generalized definition. In more concrete cases, it may foresee export processing zones, bonded warehouses, the zones of free entrepreneurship, technological parks and some others. According to international experience, they may include also its own administration, customs agency, post office, telegraph, employment agency, banking services, necessary infrastructure (water, energy, fire), residential areas and districts for investors and workers, as well as other

necessary services. In other words, it may look like “a town of free entrepreneurship and production activities”.³⁹⁶

The Uzbek parliament adopted the national law “On Free Economic Zones” pretty long time ago, in 1996. But actually, no significant progress has been marked, as well as the concrete mechanisms to bring it into action in the given period.³⁹⁷ On the one hand, the work at best stalled most likely because of introduction of foreign exchange restrictions in the late 1996; and on the other hand, the government expected first the sufficient foreign inflows, and only then, to continue works on such projects.

In this regard, general success in Uzbekistan in pursuing export promotion strategy and attracting foreign capital will apparently depend on how the country succeeds in arranging the work of such local economic areas. This success will be also related to the encouragement of efficient management which may reduce transaction costs of production activities (registration, licensing, rapid and transparent local decision-making process), i.e. the functions which could be fulfilled by the administrative bodies of such economic territories. These on-site administrative bodies would be more capable to monitor local business and foreign investors and its activities and, therefore, be better informed of their problems. However, regional and central authorities would coordinate their efforts in improving local infrastructure (transport, communications, energy system, etc.), which are hardly covered either by local authorities or new-coming investors. These investments would be apparently provided by state budget. However, foreign involvement could be also possible as a result of concrete negotiations and mechanisms with foreign partners.

For Uzbekistan, the choice of possible places with the specifically favorable privileges may not be simple as it may look like. Since some free economic areas would be supposed to be

³⁹⁶ Economic zones could also be efficient as technopoles and scientific parks which may also contribute to industrialization and export expansion. The experience of South Korea is a representative example in this regard. The role of the Korean government was in establishing the Korea Institute of Electronics Technology, the Electronic Technology Research Institute, and the Korea Advanced Institute of Science and Technology, to bring about technological advances in the electronics, in particular in semi-conductor industry. The role of technological and scientific institutions located in such technopoles or around main industrial cities made their contribution on each stage of a product’s development, starting with the research and touching upon production processes. Moreover, according to the incentive scheme, foreign affiliates carrying advanced technology were subject to a complete exemption of corporate income tax for the first seven years and a 50% reduction for the next three years. These firms are also eligible to locate their facilities in industrial complexes reserved exclusively for foreign affiliates. By pursuing such policy, the investment climate in the Republic of Korea seems to be more favourable for FDI with high technology. See also: Hong S., Gray S.J. Attracting of FDI to the Republic of Korea: Foreign Affiliates Satisfaction with Government Policies. Magazine *Transnational Corporations*, Vol.12, No 1.

<http://www.unctad.org/Templates/webflyer.asp?docid=4268&intItemID=2926&lang=1>

³⁹⁷ There has been no established and functioned zone in the country from that time onwards, at least to meet the required characteristics.

created in the rural areas too, it might make this process especially difficult. Very often, rural areas are the most densely populated territories with relatively poor developed production and social infrastructure without which such zones are unable to do well. On the other hand, successful experience of the South East Asia, for example, is mainly explained by the fact that many export processing zones were set up close to large industrial cities and seaports, such as Seoul, Taipei, Bangkok, Shanghai.³⁹⁸ Therefore, it becomes reasonable to establish such zones in the areas which are not so far away from the local regional centres and their infrastructure facilities. In addition, these zones could be also effective in the border areas, since in such a way, one may reduce transport costs for exports, equipment and raw materials imports as well as benefiting from the large undeveloped potential of cross-border trade links.

In the recent past, the government abided by the strategy of seeking 50/50 joint ventures between foreign investors and national partners. The rationale of this approach viewed the significant equity stake for the national partner as ensuring full participation and acquisition of skills for the national partner. “*FDI as not just to create jobs; Uzbeks want to learn and be able to compete*”, was emphasized in an interview by one of the top local officials.³⁹⁹

Through the improvements in infrastructure facilities and ensuring targeted tax and fiscal privileges to the investors, the host country may then put into the agenda its own suggestions too. In the given context, such economic zones may also envisage commitments of the foreign investors to use the minimum local content of domestic factors of production, such as labor and raw materials.⁴⁰⁰ Yet, one of the crucial elements in designing free economic zones is that potential foreign investors will be seeking for the contacts with domestic suppliers of resources and enterprises too. This may be explained not only by the intentions of investors to reduce their operational costs, but also with the purposes of expanding volumes of sales, including those in the domestic and adjacent regional markets. Unfortunately this aspect of the relations still remains controversial. In a row with the investors who have a half mind to

³⁹⁸ Mirzalieva S. Analiz Sozdaniya i Razvitiya Svobodnyh Ekonomicheskikh Zon v Yujnoy Koree. Magazine *Ekonomicheskij Vestnik Uzbekistana*, 2000, No 6.

³⁹⁹ An interview with M. Askarov, former First Deputy Minister of Foreign Economic Relations and currently the Chairman of State Committee for State Property and Development of Entrepreneurship (Goskomimushestvo) during a meeting with a mission of UNCTAD in Tashkent in December 1997. Quoted from UNCTAD Investment Policy Review of Uzbekistan. UNCTAD, 1999. <http://www.unctad.org/en/docs//poiteipm13.en.pdf>

⁴⁰⁰ For instance, Taiwan set up the requirement of minimal 25% of total export value added. In Malaysia, the government required from the foreign companies to provide certain managerial positions for the Malaysians in exchange of the given privileges, while income tax did not discriminate against residents and non-residents. See: Bektemirov I. Malaysiya: Ekonomicheskij Rost i Ustoichivoye Razvitiye. Magazine *Ekonomicheskij Vestnik Uzbekistana*, 2000, No 7. These actions, however, were well-grounded and balanced and did not engender discontent among investors. The requirements were not brought forward all at once, but came after the consequent improvements in general conditions, which had been in principle stable for years to earn more credibility among investors. In turn, local labor force was also already proficient enough to claim for them better jobs and better salaries.

encourage their foreign suppliers to relocate to Uzbekistan and so introduce backward linkages, there is a concern and dissatisfaction with the cost and quality of local supplies and services.⁴⁰¹

In such cases, the restrictions on competitive import may discriminate export-oriented industries due to their dependency on the imports of intermediate goods and raw materials, as well as making the import substitution sector more attractive for investments. In terms of retained import restrictions in Uzbekistan, the costs of local content may then bring to the low export competitiveness of the products and reorientation of the activities towards domestic markets.⁴⁰² Most probably, the solution to this problem would be found in time of the negotiation process with each particular investors and after consideration of mutual capabilities and conditions to take proactive measures to bring about necessary improvements.

One equally needs not to forget that the role of such special zones which they played in export promotion, differed considerably across countries and over time. In Taiwan, they accounted for three quarters of the trade surplus during 1971-1980. Parallel to trade liberalization, their role declined substantially. The same is true for Korea, where free trade zones accounted for less than 3% of exports and imports in 1990. This share has remained below 10% in the Philippines, although free trade zones were preferred export promotion schemes.⁴⁰³ In China, in the middle of the 1980s the establishment of free juridical space with the slogan “hands off” was much more influential factor for FDI inflows, than the setting up of free economic zones with specific privileges.⁴⁰⁴ At the same time, other researches show that that the Special Economic Zones designated by government turned out to be important factors affecting the location of inward FDI in China and subsequently attracting significantly more foreign manufacturing affiliates.⁴⁰⁵

Thus, the development of free economic areas in Uzbekistan could serve as another tool to back up the outward-oriented policy through foreign capital inflows. This policy may bring many advantages, if it is organized and pursued properly. International experience in South East Asia points to the necessity of good governance, proper infrastructure facilities, essential

⁴⁰¹ Investment Policy Review of Uzbekistan. UNCTAD, 1999. <http://www.unctad.org/en/docs/poiteiipm13.en.pdf>

⁴⁰² Such a situation was observed in the Phillipines, for instance, where export promotion remained isolated and was not supplied by effects of import liberalization. See: Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwistschaft, Kiel, November, 1995. p.11

⁴⁰³ The same. p.15

⁴⁰⁴ See also Pomfret R. Foreign Trade Policy For Economies in Transition. Magazine *Ekonomichskoye Obozreniye*, 1998, august, p.41

⁴⁰⁵ Cheng, Leonard K. and Yum K. Kwan (2000). “What are the determinants of the location of foreign direct investment? The Chinese experience”, *Magazine of International Economics*, 51 (2), pp. 379-400.

services, macroeconomic environment. However, the efficiency of such zones will not be significant, if they do not exert competitive pressure on the rest of the economy via input and output linkages. In terms of Uzbekistan, it requires some balanced policies to diminish the risks of excessive import substitution with the detriment to much-desired export expansion. The question remains open, which territories of the country could be endowed with better conditions to make such zones operating efficiently. The specifics of geographical location, demographic conditions, and domestic mineral base, may require from Uzbekistan much more active efforts in the given direction than other countries did in their time.

5.4. Summary

The economic developments in Uzbekistan in the second half of the 1990s were dominated by foreign exchange and trade restrictions. As a result, it was hardly able to maximize the positive, if any, effect in the developments in the foreign economic sector. Although the government still has a clear view about the economic development model which it follows, the philosophy of selective favouritism of private investments was insufficient, due to its limitations, to benefit from broad investment inflows.

Yet, in new terms of the needed reforms, especially if it relies seriously on the foreign sources of economic growth, a number of both domestic and external factors should be taken into consideration. In other words, where can Uzbekistan, within the ambit of the current economic models in Central Asia, clearly adopt better policies and procedures? But there are still some areas where Uzbekistan is far from being the successful, despite its rich potential. Therefore, there is a strong need and opportunity to improve.

- ❖ International experience witnesses that the reform in the foreign economic field, if pursued on a long-run basis, is conducive to sustainable development. In case of Uzbekistan, which has spent many decades in the isolation from the world community, these reforms are of both economic and political significance. On the one hand, this is an area which ensures much-needed export earnings and foreign investments that in turn are crucial to pursue domestic reforms, raise production efficiency, create new jobs, fight with poverty and raise income. On the other hand, the reforms in this area are important in terms of further comprehensive integration of the country with the world community. The given sphere is a primary intermediary which conveys substantial amounts of social, political and economic information and other intangible resources to and from the republic without which no sustainable progress in all areas is possible nowadays.

- ❖ Liberalization and optimisation in the foreign sector are two parallel processes within the general strategy. If liberalization concerns more freedom and sovereignty to economic units, optimization will deal with the improvements in government policies through less centralization and direct government interference in foreign economic relations. Moreover, sustainable economic growth is most probably related to further structural changes in domestic economy, adequate import and export policies.
- ❖ In this regard, export promotion is expected to play a cordial role. With its traditional industries, including the light and textile ones, it looks equally important to support the diversified export structure and, therefore develop and strengthen new industries too, such as electronics and home appliances, for example. Some lessons from Asia suggest that targeted measures of the government with the use of trade, fiscal, tax, administrative tools are essential, but not the only steps on the way to a final goal. They should be consistent with government credibility through improvements in the tools and methods of domestic policies, as well as by ensuring sound macroeconomic environment with real export-induced bias. Long-term success of export promotion strategy will be also crucially attributable to the fact, how efficiently the process of technological transfer will be taking place and how properly these technologies are going to be adapted to local conditions and subsequently treated by local labor force. Finally, institutional and technical support for export promotion is expected to contribute to local exporters in expanding their opportunities, knowledge and skills to behave in foreign markets.
- ❖ It is crucial to proceed with the work on the reinforcement of domestic legal base, especially towards FDI. This will require not only the adoption some new national laws, in order to fully use comparative advantages of the republics in international division of labor, but also improvements in the existing ones on the way to simplification, transparency and consistence. The development of legislative power and the judiciary system is going to be an integral part of the given process.
- ❖ Further work needs to be done in order to strengthen the institutional base of government regulation. It does not necessarily imply the expansion of the staff of state apparatus to control over the foreign sector. On the contrary, in the light of the administrative reform, existing state bodies are required to be more flexible and optimal, as government interference is substituted more by market-regulated mechanisms.
- ❖ For Uzbekistan, like for many countries, FDI seem to be the much-needed source of long-run sustainable development. FDI is undeniably a more stable source of finance than

portfolio investments, but should be seen as a complement, rather than a substitute to public finance. International experience shows that FDI flows are moderate, if the host country has poor legislation, inconsistent court system, burdensome state machine and bureaucracy, lots of foreign restrictions, highly regulated and dependent banking system, etc. Foreign investors have broad sources of information to compare and analyse before going to a final conclusion. They may include not only officially accepted international reports (and not only purely economic), independent surveys of NGOs, conferences, expos, etc., but equally be based on rumours and personal experiences. Political factors may influence the acceptability of policy measures. The responsiveness of investors to policy changes and, thus, the adjustment flexibility of the economy is likely to be higher if the government's credibility is beyond serious doubt. Consequently, all the factors are strongly correlated which requires a more thorough and multi-dimensional approach to touch upon the whole specter of issues and not foreign economic development only.

- ❖ At the same time, as international experience reveals, it is sometimes a complex task to define which of the factors may have optimum and direct effect on the developments with export promotion and FDI. But as the appropriate package of export promotion measures is devised, it should be kept in mind that specific export incentives in terms of tax or tariff exempts and drawbacks, financial support through credits and subsidies can only be complementary and cannot substitute for sound macroeconomic policies, the main indicators of which are low inflation, adequate foreign exchange and trade policies, etc. For FDI, however, it becomes clear that stable macroeconomic environment is an important, but not a sufficient condition today. The world trends show a lot of additional targeted efforts pursued by the governments to attract FDI or encourage sustainable export promotion. Moreover, some new criteria, such as the credibility of recipient governments, the state of democratic development, human rights, etc. are also taken into consideration.
- ❖ Economic transformation in Uzbekistan involves quite diversified policy tasks. In particular, the country is due to continue in dealing with the institution building, macroeconomic stabilization, structural reforms, privatization, as well as with irreversibly committed political and democratic reforms. As reforms in these areas are firmly rooted and strongly pledged, the uncertainty as to general investment conditions may be avoided.
- ❖ The foreign economic sector is going to develop well, if the appropriate system of the various forms of insurance from the risks of doing business or exportation, both for domestic and foreign investors is in place, in addition to drastic industrial restructuring

and appropriate development of financial and capital markets. All of them should reflect government priorities for the republic in the middle- and long-run.

- ❖ Analysis shows that one of the greatest challenges in the foreign sector is a chronic shortage of both general and commercial information. According to international experience, one of the possible solutions is to develop the public system of information for foreign economic activity. The system may collect and analyze necessary information, in order to subsequently provide it to the parties concerned. The system may have many branches and be widespread across the country. In addition, there is a strong need for another publicly managed set-up in order to fill in the institutional and marketing gap in foreign trade. Its strategic task should be broader assistance to economic units in market research, product development, advertising Uzbek products abroad, attendance in international fairs, etc.
- ❖ Openness and transparency in foreign affairs is much dependent on the measures to communicate with the outside world. The task of the government policy in this particular case is not only to eliminate technical, bureaucratic and other administrative barriers on the way of foreign and domestic investors, but also to perceive and expand the role of information by conducting and using its consequent information strategy with the help of its own institutions, both domestically and abroad, and as well as capacities and opportunities of mass media, foreign investors, international organizations.
- ❖ If the barriers in Uzbekistan's foreign trade are to hold in the foreseeable future, mainly because of the current priorities in the industrial sector, the possible drawbacks could be to some extent eased through the establishment of free economic areas. The latter will be also crucial in complementing outward-oriented, export promotion strategy. This policy may bring a plenty of advantages, if it is organized and pursued properly. International experience in South East Asia points at the necessity of good governance, proper infrastructure facilities, essential services, macroeconomic environment. The peculiarities of geographical location, demographic conditions, and domestic mineral base, however, may require from Uzbekistan much more active efforts in this direction, than other countries did decades ago. But, with the steps towards further trade liberalization the needs for such zones and their subsequent role is going to be diminished.

Chapter VI. THE PROSPECTS FOR REGIONAL (CENTRAL ASIAN) COOPERATION

6.1. Theoretical Aspects of Regionalism

6.1.1. Definition and Theories of Regionalism

A great deal of debates are currently devoted to the issues related to socio-economic and political events in the entire CIS space. On the one hand, it could be seen as another reflection of the trends explained by causes and consequences of the emergence of various regional unions and blocs, as well as their role in the deepening interdependence between countries and regions. Not at least, it could also be related to the general geopolitical situation in the world as a result of the demise of the Cold war political order and subsequent shifts in foreign policy doctrines of major powers which are actually determining the situation in the priority geographical, economic and political areas. The new emerging territories, regardless of their natural or cultural distance, could equally become the place of both shared interests and conflicts due to their rich and untapped potential.

One of such places in international relations after the 1990s has been Central Asia, the five countries of the former USSR that were little known internationally during the Soviet period.⁴⁰⁶ The established contention that regional cooperation in Central Asia has already proved to be a very specific, controversial and long-lasting process rather than successful regional integration efforts assumes the solid, sometimes even finalized shape. The regional initiatives are regarded as an allegedly completed process featured with the dismal history record and even more vague outlook. Whereby, however, the fact is underestimated that these countries with relatively young history of independent development are still to confront with parallel challenges on national building, institutional and structural reforms, security and political dilemmas. In the given light, study of regional processes requires conducting a more in-depth analysis with a particular emphasis on the factors and reasons allowing to better understand Central Asia's regional history and to devise its own formula for future development.⁴⁰⁷

First and foremost, the analysis of regional trends requires giving a definition of “regionalism”. It needs to be emphasized that many of the debates on the given issues are based on a few principal notions - “integration” on the one hand, and “regionalisation”,

⁴⁰⁶ That is Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

⁴⁰⁷ Some scholarship are used to look at the region as a part of the Caspian basin in the light of energy resources and their role in contemporary international politics. Others refer to a wider territory called a Central Eurasia, embracing in addition to the aforementioned five republics, also Afghanistan, Iran, Turkey, and even the northwestern part of China. Our focus has been basically made on the regionalization efforts between the former Soviet Central Asian states in the past, the role of Uzbekistan, and the specific impact of bi-and multilateral involvement on its future potential.

“regionalism” and “regional cooperation” on the other.⁴⁰⁸ While the former was actively used in political and scientific circles in the Central Asia region itself, the others were the definitions given by western researchers to highlight regional tendencies in post-Soviet Central Asia. In view of a strong interrelationship between these terms, they most probably were treated as synonyms. However, we need to specify clearly some particular differences. In more general sense, “regional cooperation” could be defined as a process of joining forces by countries or groups of countries on the bi- and multilateral basis, who have and perceive common interests in various fields. This action is needed to maximize favorable effects from such common efforts on each single country which is unable to achieve these effects if it would act unilaterally. In order to enable these processes to develop in some organized and proper manner, countries may coordinate their moves in particular areas by steadily increasing the extent of such coordination. The latter may be obtained further through the establishment of certain intergovernmental and non-governmental structures and bodies in each area of a mutual concern. These structures could be agreed from the outset of regional cooperation, as it was in the EU, to monitor, analyze and take the decisions and rules which are usually mandatory for all country members and their national set-ups. Equally, however, they may come into life after concrete cooperate links and projects on the economic and social levels have been implemented successfully. Then, institutionalization takes place on the basis and as an outcome of positive practical experience in the past, as it mainly happened in East and South-East Asia.⁴⁰⁹

As for “integration”, the term may be used to express different processes. Equally, however, one needs to differentiate between the types and the stages of integration.⁴¹⁰ Although the types may differ from its relatively simple one (free trade area) towards more complex and ultimate one (economic and political union), some elements may exist simultaneously in a few types. For example, free capital and labor mobility which is normally pertains to common

⁴⁰⁸ Although these terms are used interchangeably, one needs to be stressed that *regionalisation* represents the process of a growing importance of regional arrangements, while *regionalism* implies these regional trading arrangements themselves. In turn, *integration* of states is seen as the higher level of regional cooperation and coordination between the states as to various methods, common norms and rules in political and economic spheres in which both state-led and market forces-led initiatives may be equally important. Hence, the term “regional cooperation” could be more relevant as to Central Asia, since its seems to be neutral to reflect the extent of both former and current relations between the states.

⁴⁰⁹ Agarwal J., Laughannen R., Luecke M., Mannerkamp P. Export Expansion and Diversification in Central and Eastern Europe: What can be learnt from East and South East Asia? Institut fuer Weltwirtschaft, Kiel, November, 1995.

⁴¹⁰ The literature refers to the five main types of integration. They are: free trade area (with no tariffs on goods and services, but autonomous tariff policy as to third countries), customs union (free trade area plus common tariffs as to third countries), common market (customs union plus free movement of all factors of production), economic union (plus coordination of economic policies), and political union (plus supranational structures coordinating non-economic issues too). See more on this in Micic M. International Trade, St.Martin's Press, New York, pp.441-465.

market or economic union may be found in free trade area too. It could certainly be easier for some countries to follow the order by starting with the more simple removal of borders and other impediments towards the free movement of products and services. Under appropriate conditions, they can thus initiate the integrative process by coordinating and harmonising economic, financial and customs policies not only to promote future development, but to overcome the existing bottlenecks too in all the countries-members of the union. Yet for some others, the elimination of the obstacles in intra-regional trade will remain the ultimate goal rather than the establishment of a more complex political and economic union.

Due to the objective limitations, the given research is certainly unable to comprise all the possible theories on this issues, but some of them which could be useful to analyze the trends in Central Asia, will be briefly set out.

In the 1940s it was a *functionalist theory* that was considered as sufficient to meet the requirements of social and economic developments between states. Since these states were requiring close technocratic cooperation in each single economic area, the postulate of functionalism declared that successful cooperation in a concrete field or project might stimulate further, even stronger integration processes.⁴¹¹

A conception of *federalism* was born in the late 1940s. In comparison with the former views, the given theory argued that hopes for integration through technocratic collaboration would fail unless a strong and constitutional structure on the regional or international level was established. This theory succeeds further by forbearance from the strategies of short-run gain by the potential cooperators in favor of greater long-term benefits to be drawn out from collaboration.⁴¹²

A *neo-functional approach*, especially developed in the mid-1980s, emphasizes the role of a political aspect and initiative functions of supranational structures on the one hand, and the reinforcement of the “spill-over” effects from cooperation in particular fields on the other. This was particularly attributable to the cyclical developments within the Western European integration which strengthened its positions in the mid-1980s after facing some stagnation in the 1970s-early 1980s.⁴¹³

⁴¹¹ Talipov F. *Teoriya i Praktika Regionalnoy Integratsii v Tsentralnoy Azii*. Quoted from Mitrany D. *The Functional Theory of Politics*. London School of Economics and Political Science. M. Robertson and Co., 1975.

⁴¹² Gleason G. *Interstate Cooperation in Central Asia from the CIS to the Shanghai Forum*. *Europe-Asia Studies*, Vol.53, No 7, 2001, pp.1007-1095.

⁴¹³ Jakobeit K. *Teoriya Regionalnoy Integratsii*. In Diter H. *Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995.

A relatively new conception of *transactionism* makes the use of quantitative methods to define the scale of integration processes. In terms of the growing exchange of products and emerging communications, as well as the new shifts in approaches from armed to other forms of conflict solutions, some kind of “security communities” has begun emerging which eventually may bring the countries under the umbrella of common political unions.⁴¹⁴

In a pragmatic way, the aforementioned approaches could stipulate the following reasons for the establishment of regional unions.⁴¹⁵ They are:

- 1) general interests of the states for regional cooperation to be formed by the existence of concrete economic and political interests; social, historical and ethnical similarities; geographical proximity, etc.;
- 2) ideological considerations and motivations which may ensure a fruitful ground for the future union;
- 3) “rational choice”, i.e. the quantitative and detailed measurement of benefits and losses coming out from direct participation in regional unions.

History of regionalism in the world contains both theoretical and empirical evidence. While the theory’s evolution eventually led to the depiction of bounds between costs and benefits from regionalism, empirical data proved to be less assertive. The latter’s contribution has come in defining the differences in motivations and in outcome of these efforts across the space and time. But the magnitude and direction of real benefits for the countries which took part in common regional initiatives was often open to debate. The main question in both political and academic circles since the end of World War II, has been whether an array of the established regional blocs does benefit a handful number of countries, i.e. those which take part in these blocs, through the mutual preferences in free trade and the protection of regional market from external competition. And if yes, then it may probably occur at the costs of the others left outside such unions which should thus lead to the diminished world welfare, when these costs for both the members and non-members of the regional unions will exceed their potential benefits. Consequently, the debates still remain on whether such trends are in compliance with the establishment of a universal multilateral system of relations in which all

⁴¹⁴ Association for South and East Asian Cooperation (ASEAN set up in 1967) could serve a representative example in this regard. Although its member countries announced a wide range of issues to keep up interstate collaboration, including economic, social, cultural, educational and other spheres, regional approach to address outside and domestic threats under the mottos of common security and stability remains the strategic task of such cooperation nowadays too.

⁴¹⁵ Jakobeit K. Teoriya Regionalnoy Integratsii. In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.5

the countries could benefit and not only those immediately involved in a particular regional bloc. In other words, the question is whether regionalism should be regarded as a stage towards the creation of a more global system or it is an attempt to resist this kind of universalized intentions.

In the given context, some questions may also arise when considering the true rationales behind the intentions to “regionalise” in Central Asia. All the regional states are seeking to integrate into the world community and favor, to a different degree, multilateralism in foreign policies. Equally, however, they are all members of many regional unions, though the fate of such unions remains indefinite. Hence, how the region is going to act in these conditions and what the impact, both political and economic, of these steps will be are the two among a number of issues on regional cooperation to be considered by these countries. Yet, in the search of some answers to these sort of questions, at first it is necessary to remind the general features of the creation and emergence of such blocs across the world in the past.

6.1.2. Some Lessons From the International Past

It is a recognized view that a significant impetus to the trends of the first regionalist wave across the developing world was given by the process of Western European integration. The initial wave of the regional unions was widespread during the entire 1960s-1970s. In Latin America, it was the Latin America Free Trade Area (LAFTA) and the Central American Common Market both established in 1960. Later, disagreements in LAFTA led to the emergence of the Andean Pact in 1969. In 1980, LAFTA itself was replaced by more flexible and less binding Latin American Integration Association.⁴¹⁶

Although far-reaching trade and political goals had been declared, it became soon clear, however, that the prospects of these regional efforts remained vague. The countries were able neither to increase their share in the world trade which, on the contrary, had diminished; nor to cope with the declining volumes of intra-regional trade too. The idea of regional success had reportedly failed. In the Latin American case, the source of these developments was the wide range of size and the level of development among its members, with small Bolivia and

⁴¹⁶ A number of regional agreements appeared in the African continent too, including the East African Community, the Western Africa's Economic Community, the Economic Union of Central Africa, and the South African Customs Union. Yet all these initiatives failed, since the African countries were all small with the low level of economic development and primary trade with non-members of the established unions. Moreover, regular inter-state political conflicts impeded seriously common regional efforts. As for Asia, it was relatively devoid of active regional economic arrangements. The focus was made on the encouragement of political collaboration and confidence-building measures. For all these see: Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.98-104.

Paraguay and larger Brazil, Argentina and Mexico. The process of industrialization caused by the regional emphasis on the import-substitution manufacturing sector development, led to the further expansion of the gap between small and larger economies. In addition, some disagreements over the redistribution of benefits from highly protected regional industries, and over the costs of the higher prices on domestic markets were the frequent case.⁴¹⁷

Another reason of the differences between the European integration and a poor performance of regionalism in the third world, particularly in Africa, was seen in the local conditions which had existed in the less developed economies. Natural resource endowment, retention of a common colonial legacy, in addition to high political orientation towards former metropoly states long after independence resulted in emerging non-diversified commodities-based local economies and slow or the absence of any economic progress.⁴¹⁸ In many respects, as a result of such orientation in foreign trade, the structure of merchandise exports among these countries made no significant differences and subsequently gave a little impetus to the development of intra-regional relations.

It needs to be underlined that the level of industrialization, as a mirror reflection of the commodity orientation in foreign trade, serves as an important pre-condition for the intensification of foreign trade. This was certainly absent or lacked in the developing countries at the time when they had decided to set up regional unions. Therefore, for such countries regionalisation in forms of various unions ended with no tangible benefits than expected at the outset of such a process. On the other hand, the goals of those countries looked more ambitious compared to true domestic and external environment. Emboldened with the elusive political dreams about regionalism, the countries seemed to set a too high tempo of integration which was later perceived to be unattainable in view of the inadequate and so far not formed political and economic potential. At last, the vulnerability of the young states due to the high dependence on the world commodity markets made them the first targets of instability in the world economy. It was especially seen during the oil and energy

⁴¹⁷ One of the points here is that in terms when intra-industry relationships are poorly developed, when foreign trade mainly hinges upon one or a few staples, then, one may reach little by joining efforts within regional structures. In other words, the benefits of the regional bloc may not be palpable until the material conditions for a deepening division of labor are secured, i.e. some minimal level of intra-industry specialization has been achieved. See: Altvater E. *Regionalizatsiya Mirovogo Rynka* In Diter H. *Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.77. Yet it is still open to debate whether a more liberal strategy towards foreign trade and market mechanisms could have resulted in better achievements for these countries. Extremely politicization of the economic issues, and conflicts between the countries had also significantly damaged the progress towards the declared goals.

⁴¹⁸ Anglo- and francophone countries in Africa continued to draw up their foreign policy, especially foreign economic policy, in conformity with the agenda of their recent parent states. See more: Jakobeit K. *Teoriya Regionalnoy Integratsii*. In Diter H. *Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995.

shocks in the 1970s. Although these were resource-rich countries, who suffered more, the subsequent slow-down in global economic growth resulted in tumbling demand for commodities and the lower prices on the main exports from these countries to the developed economies. It happened at the moment, when developing countries, especially relatively poorly endowed with natural resources, had to confront with the de facto high and unsustainable amounts of foreign debt. This eventually undermined all the efforts on sustainable regional development.⁴¹⁹

Later on, the next wave of regionalism started spreading across the world during the 1980s-1990s. As so called “new regionalism”, it could be characterized as “an attempt to find answers to the challenges coming out from global structural crisis and strengthened international competition exacerbated by financial instability in the world”.⁴²⁰ NAFTA (North American Free Trade Association) and Mercosur (South American Common Market) are the cases of regional unions during the second wave of regionalism in the world. The peculiarity of these unions is that their birth was connected not only to purely economic reasons.⁴²¹ Mercosur was the most important of the Latin American initiatives in terms of the size of the economies involved (Argentina, Brazil, Paraguay, and Uruguay) and called for a common market from January 1995 with free movement of goods, services, labor, and capital.⁴²²

At this moment, some differences were in place between the first and second waves of regionalism. The approach of bringing forward common interests as a group was believed to be a more or less efficient way to defend national interests in negotiations with the rest of the world, especially on multilateral agreements. The policy orthodoxy itself was shifting during the 1980s from import-substituting industrialization towards more outward-oriented and

⁴¹⁹ For debt crisis in the 1980s see in Micic M. *International Trade*, St.Martin's Press, New York, pp.261-267.

⁴²⁰ Altvater E. *Regionalizatsiya Mirovogo Rynka In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.83

⁴²¹ Some analysts believe that the US policies towards integration with the economically much weaker Mexico could above all witness about a combination of both the tactical steps to open up the Mexican borders for American capital, and the US strategic interests in response to intensified competition from the European continent and South-East Asia given the geographical location of the USA between these two continents. See for instance: Altvater E. *Regionalizatsiya Mirovogo Rynka In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.99. Equally, however, this process did not go smoothly. Especially in the case of Mexico, this initiative faced significant resistance in the US Congress. Although the idea of equal partnership between the strong and the weak was undermined, the US Administration had to make a few serious revisions of the operating procedures to the signed Agreement before it was put into action. On the other hand, the North American integrative initiatives, both pre-NAFTA (which is Canada-US Free Trade Agreement, signed in January 1988) and NAFTA itself reflected the interests of the smaller countries too. Canada and Mexico were the initiators of these initiatives: both wanted to safeguard its position from the American unilateralism launched in the mid-1980s by Congress and the R.Reagan administration against unfair trade practices in trade partners. But the latter also wanted to use a trade agreement to promote foreign investment and support for its neo-liberal reforms. Moreover, president of Mexico was reportedly influenced by a trip to Europe in which he observed the EU countries looking only east towards Central Europe. Find out more on North American regional initiatives in Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.135-143.

⁴²² Similar patterns were observable in Africa, the Caribbean, West, and South Asia, but with less practical results. The only exceptions were East and Southeast Asia which remained cautious with regional trading arrangements until the mid-1990s. See more on that in Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.143-148.

market-friendly development strategies. Developing countries became increasingly willing to accept the obligations of GATT members (as to more liberal trade policies) and simultaneously seek the rights of such membership (in the form of legal guarantees to market access). Given the greater importance of US, EU, and Japan's domestic trade policies for developing countries, GATT became the principal multilaterally negotiating forum in which developing countries began to play an active role for the first time ever.⁴²³

Conclusion of the most long-lasting Uruguay Round multilateral trade talks was to some extent successful in assuaging the regionalism-versus-multilateralism issue by favoring free trade globally.⁴²⁴ The reform of dispute settlement procedures and the establishment of discussion panels in the newly organized system of multilateral trade within WTO on the basis of the former GATT limited the potential for unilateralism from developed countries, and helped thus the developing economies to negotiate trade on more equal footing.⁴²⁵ The WTO relieved some restrictions on the establishment of regional blocs in the world under particular conditions, as well as introduced a special clause on regional unions between developing countries.⁴²⁶ With these opportunities, developing countries were keen to set up various regional unions with and without supranational structures. The latter were regarded as a tool to contribute to both a policy-making process in response to global trends and international trade on the one hand, and to the simultaneous protection of national interests through the step-by-step promotion and reinforcement of regional competitiveness on the world markets dominated by industrially developed countries.⁴²⁷

⁴²³ Find out more on these specific issues in Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.128-156.

⁴²⁴ Some authors note, however, that it was just the loss of momentum in the multilateral trade negotiations during the GATT Uruguay Round which caused the rising interest to regionalism in the 1990s. See: Micic M. *International Trade*, St.Martin's Press, New York, pp.523-528. For the overview of the GATT Rounds see in Hockman B., Kostecki M. *The Political Economy of the World Trading System. The WTO and Beyond*, Oxford University Press, 2001, pp.100-108.

⁴²⁵ For the mechanism of dispute settlement procedures see in Hockman B., Kostecki M. *The Political Economy of the World Trading System. The WTO and Beyond*, Oxford University Press, 2001, pp.74-99.

⁴²⁶ Article XXIV of GATT foresees the following three conditions to form customs unions and free trade areas: trade barriers facing non-members must not "on the whole" be higher than those previously in effect; trade barriers must be eliminated on "substantially all" trade among members; interim arrangements to permit scheduling these unions must be completed over a reasonable period of time. See: Hockman B., Kostecki M. *The Political Economy of the World Trading System. The WTO and Beyond*, Oxford University Press, 2001, pp.352-255. But experts agree on the internal controversies and poor practical efficiency of this article in terms of other obligation within the non-discrimination principle of the GATT. See more on these critics in Micic M. *International Trade*, St.Martin's Press, New York, pp.519-522; Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.74-76.

⁴²⁷ These processes seem to continue nowadays too. In South America also one may observe regional and national desire to acquire additional political weight in order to operate as a common trade grouping during the negotiations in multilateral trade. The latter most probably implies to increase region's clout in trade talks with South America's main trading partners (EU, Japan, USA), which still continue to be the outside economies. Despite a number of outstanding difficulties, the countries are moving purposefully towards the creation of stronger regional identity. At first the Andean Community of Nations (CAN) and Mercosur signed a trade deal in July 2004 to open up trade across the continent. The CAN includes Bolivia, Colombia, Ecuador, Peru, Venezuela, while Mercosur's members are Brazil, Argentina, Paraguay and Uruguay and Bolivia, Chile, Mexico, Peru and Venezuela as associate members. On December 9 2004, representatives from 12 South American countries went even further, when after the meeting in Peru they signed another agreement to set up a political and economic bloc modeled on the European Union. While skepticism is present over the successful future of the new Union,

In addition, contemporary trends in regionalism are supported by the mutual reinforcement of economic and political rationales. In terms of the established economic and trade relations among countries, total volumes of regional trade occurs at the rates higher than those with the rest of the world. Economic linkages tend to reinforce which in turn secures more active collaboration in political dimensions. Such patterns pertain to the Asian regionalism (ASEAN, APEC) under the slogans of regional cooperation and integration in a pragmatic and gradual way. Its main feature is that these processes may happen before institutionalization and the strong adherence to the binding obligations which is not regarded as an indispensable condition. Moreover, modern regionalism is driven more by the ideas to strengthen key positions in international relations through the mergers with the previously formed regional unions (Latin America), the expansion of membership by admitting new members or directly through bilateral negotiations to comprise new aspects of regionalism (Asia),⁴²⁸ or the emergence of biregionalism.⁴²⁹ The following table summarizes the importance of regional bloc trade in different parts of the world.

Table 6.1. Share of Intra-regional Trade in Total Trade, various regions, 1928-2003

	1928	1948	1963	1973	1983	1993	2003
Western Europe	50.7	41.8	61.1	67.7	64.7	69.9	67.4
Central and Eastern Europe	19	46.4	71.3	58.8	57.3	19.7	25.9
North America*	25	27.1	30.5	35.1	31.7	33	32.3
Latin America	11.1	20	16.3	27.9	17.7	19.4	16.9
Asia	45.5	38.9	47	41.6	43	49.7	53.5
Africa	10.3	8.4	7.8	7.6	4.4	8.4	10.6
Middle East	5	20.3	8.7	6.1	7.9	9.4	8.8
World	38.7	32.9	44.1	49.3	44.2	50.4	50.5

* Mexico is included in Latin America

Source: Updated from Micic M. *International Trade*, p.444; WTO *International Trade Statistics* 2004.

both in regional and bilateral relations across the region, the initiators believe that it could one day “have a common currency, parliament and passport”, help better “confront the challenges of globalization and of new political and economic order”. It represents 45% of the total American continent, with GDP of about \$973 mln., export of \$181 mln. of goods and services and 361 mln. of population. Sources: South America Trade Bloc Expands, BBC News, 08 July 2004; South America Blocs in Trade Deal. BBC News, 19 October 2004; South America Launches Trading Bloc, BBC News, 09 December 2004.

⁴²⁸ ASEAN – Association of South East Nations, APEC - Asian Pacific Economic Cooperation could be taken as examples. The most recent event is the ASEAN-China trade accord, which unites 10 South East Asian economies and China in a single market worth \$2 trln. and a quarter of the world’s population. The countries committed to lower tariffs by 2010 and create free trade area in the region. Moreover, wider ambitions are behind plans for East Asian Summit, including “ASEAN plus 3”, i.e. China, Japan and Korea as a means to create a trade bloc to rival the EU and the USA. Especially after the 1997 financial crisis, in Asia Pacific bilateral negotiations on capital movements and financial services were also mushrooming, which marked a new aspect of regional trends. For more information see: China in Landmark Pact: a Landmark Trade Agreement between 10 South East Countries and China Has Been Signed at a Summit in Laos. BBC News, 29 November 2004.

⁴²⁹ A case of biregionalism gathers its force in the relations between the EU and Latin America as a response to the recent trends in a globalised world system. Referred on the part as a “defence strategy” to strengthen bargaining positions against the two economic giants, such as the USA and the EU, it comprises a multilevel mechanisms on political dialogue and economic diplomacy to serve Latin America’s foreign policy goals on diversification and growing multilateralism in new terms. See more on that: Grabendorff W., Seidelmann R. (eds.) (2005) *Relations Between the European Union and Latin America: Biregionalism in a Changing Global System*. Nomos Verlagsgesellschaft, Baden-Baden.

To sum up, the efforts and willingness to set up regional blocs in the various parts of the world in the past was influenced by a number of specific economic and political factors. In the developing world, the given process seems to require another, most probably longer timeframe for objective reasons, such as lack of sufficient funds, dependence on foreign capital and international donors, absence of transnational corporations capable to implement such investments (Annex 6.1). The regionalism in the world in the past took various forms which differed by their nature. But there should be links between the waves of 1950s-60s and 1980s-1990s which reflect in that this regionalism was substantially provoked by national trade policies of the USA, Europe, and Japan towards each other and towards the third parties. For the latter, it is thus believed to be “difficult in terms of being secluded from the gravity of industrial countries. The terms of both national and regional policies are drawn up in the world of industrial countries; the IMF-led international financial system, World Bank, WTO. Neither regional blocs, no single countries are able to get isolated from the world markets. It thus leaves only some medium way between a defenseless openness, and a voluntary or forced seclusion... When moving forward this way, the regional spaces (blocs) may be useful, but only on the provision that political value added could be turned into an extra economic potential through sound economic policies”.⁴³⁰

6.2. Central Asia: Vision, Reality, Challenges Ahead

6.2.1. History of Institutionalization

This chapter is going to cover a process of institutionalization of cooperation efforts in Central Asia in the sphere of economics. Then, it deals with a comparative analysis of the declared goals with the evidence of real progress made in the past. The reasons of failure in regional cooperation will be put under special scrutiny, while some debates on the specific conditions for regional initiatives in Central Asia will finalize the chapter.

Regional groupings and subgroupings which involved the Central Asian states, could be seen as a part of the general resurgence of regionalism in the post-Soviet international order since the early 1990s.⁴³¹ The idea of the subregional structure within the region goes back into the

⁴³⁰ Translated by the author from Altvater E. Regionalizatsiya Mirovogo Rynka, in Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.108

⁴³¹ The list of groupings and characteristics to their activities in the CIS space are analysed in detail by List D. within the given project. See her work “Regionale Kooperation in Zentralasien: Hindernisse und Moeglichkeiten”, pp.131-190. For their role in Uzbekistan’s foreign policy, see Inomjonov Kh. “Aussen und Sicherheitspolitik der Republik Usbekistan in den ersten Jahren der staatlichen Unabhaengigkeit“ within the Central Asian project.

Soviet time. In 1990, the republics of Middle Asia and Kazakhstan, as the region was officially called under the Soviet ruling, undertook the first attempt to join forces in pursuing structural changes to improve domestic situation. For this purpose, a corresponding Agreement on economic, scientific and technical, and cultural cooperation was signed between the states.⁴³² This initiatives was necessiated by much-needed strategic changes in the established resource and commodity-based orientation of local economies and deteriorating environmental conditions, but also to prevent social catastrophe caused by worsening in public health, growing child mortality rates, as well as by the unsatisfactory foodstuffs supplies to local people.⁴³³ On the other hand, it corresponded to the reform-oriented changes in the Soviet policy aimed at the partial transfer of the Union's functions to the republics at the time of perestroika to address certain issues of economic policy.⁴³⁴ As a result, by the end of the 1990s, all the Central Asian republics, along with the other republics of the USSR, had adopted the Declarations of "National Sovereignty". The definition of "socialist national sovereignty" at this point was a peculiar one, since it meant sovereignty within the confines of the USSR.⁴³⁵

With the declaration of independence, in part to address their common problems and prevent their further marginalisation in the new post-Soviet era, but also to ensure smooth integration into the world community, Uzbekistan, Kazakhstan and Kyrgyzstan signed a Compact on Creation of Common Economic Space on April 30 1994, which gave birth to first regional institution called the Central Asian Union. Its main purpose was defined as implementation of joint programs on deepening economic integration, and the establishment of conditions for free movement of goods, services, labor, and capital; concerted steps in pursuing credit and accounting, fiscal, tax, price, customs and foreign exchange policies.⁴³⁶ The document became a legal basis for cooperation between the four states, after Tajikistan was also a signatory since 28 March 1998.

⁴³² See Zayavleniye Rukovoditeley Rukovpditeley Uzbekskoy SSR, Kazahskoy SSr, Kyrgyzskoy SSR, Tadjikskoy SSR, Turkmenskoy SSR. Na Puti Sotrudnichestva i Progressa. Tashkent, 1990.

⁴³³ The same, pp.7-8.

⁴³⁴ However, the given factor seemed to exert a moderate influence on the region. Some other authors are convinced that these shifts in the Soviet policy had barely or no impact on the peripheral parts of the USSR, such as Central Asia. Therefore, the regional republics benefited little from pro-reformist novelties of the Centre and still kept on highly dependent on the financial injections from Moscow up to their full independence. See Pomfret R. Development Strategies and Prospects for the Future. Materials of International Conference "Central Asia 2010", UNDP, 2001, pp.58-65.

⁴³⁵ Gleason G. Inter-State Cooperation in Central Asia from the CIS to the Shanghai Forum. Europe-Asia Studies, Vol.53, 2001, No 7, p.1080.

⁴³⁶ See Agreement between the Republic of Uzbekistan, the Republic of Kazakhstan and the Kyrgyz Republic on Common Economic Space. Sbornik normativnyh dokumentov, Ispolnitelnyy Komitet Tsentralnoaziatskogo Sodrujestva. Alma-Ata, 1995

Three months later, the organization was given a new name, Central Asian Economic Union which particularly emphasized the role of economic criteria. It needs to be seen as a main force in bringing countries' economies closer to each other through elimination of borders, harmonization of rules and norms for local economic entities and for physical persons. It is worth noting that the emergence of the given organization was not regarded as a counterpoise to integration initiatives within the entire CIS space, as the leaders of the local republics repeatedly pointed it out.⁴³⁷ In general, the Central Asian Economic Union was an institution open to any other new members. In this regard, for example, first, Russia in 1996, then Georgia, Ukraine and Turkey in 1999 were granted an observer status.⁴³⁸ But it came out primarily as a result of common regional interests to look for the ways for a more rational use of regional resources in the worsening economic situation, partly caused by the collapse of trade relations with the other parts of the former Soviet Union. As the President of Kyrgyzstan pointed out on this occasion in the early 1990s: *“We should meet each other from time to time in order to discuss our work, the measures taken in our republics. Our main task is to set up a common infrastructure for the republics of Central Asia to move towards a market economy”*.⁴³⁹

In this sense, the signed Agreement on Common Economic Space counted on the availability of conditions in the region which could make the regional cooperation an expedient and purposeful process underpinned by regional logic: geographical proximity; language and socio-cultural mentality; intentions and willingness of the elites to reinforce friendly relations; necessity for common resource and infrastructure development. The latter implied common transport and energy infrastructure built in the Soviet period. Due to local geographical conditions, the use of water and energy resources, was regarded among the main conditions to secure sustainable economic development. Besides, it was in line with other priorities, such as environmental protection and national security concerns to meet regional demand and look at the prospective export routes to reach the world markets. It was also at this stage of development when the appropriate resolution on the establishment of international

⁴³⁷ The CIS, in turn, was seen as a vehicle to retain traditional, especially economic linkages capable to prevent from negative impacts of the post-Soviet turmoil and to consolidate their ways to national independence. Nevertheless, the spirit of dissatisfaction by the activities in the frame of CIS, appeared to exist locally, sometimes even being made publicly known. The President of Kazakhstan, for instance, noticed after the meeting of the Central Asian leaders in Astana in 12 December 1997 that if the CIS did not show real equality among its members, then it would turn into something that would rather not have been at all. See: Sakwa R., Webber M. The Commonwealth of Independent States: Stagnation and Survival. *Europe-Asia Studies*, 51, 3, 1999, p.379, Talipov F. *Teoriya i Praktika Regionalnoy Integratsii v Tsentralnoy Azii*, Magazine Central Asia and Caucasus, 2002, No 2, p.94.

⁴³⁸ Ushakova N. *Tsentralno-Aziatskoye Sodrujestvo – Napravleniya Transformatsii*, Magazine Central Asia and Caucasus, 2003, No 3, p.143.

⁴³⁹ Newspaper «Narodnoye Slovo», 3 November 1998.

consortiums, initially only the three ones (in water and energy, food, and in mineral resources) was taken. At that period Turkmenistan, being absolutely skeptical on any regional and CIS developments, also expressed its concerns in common efforts. In particular on 5-6 1998, the regional meeting of the heads of states was held in Ashgabat, the capital of Turkmenistan, at which the matters on the development in the oil and gas potential, and cooperation in possible regional pipelines projects, along with other political issues were thoroughly discussed.⁴⁴⁰

Equally there was cooperation in the financial sphere too, after the Central Asian Bank on Cooperation and Development was set up in 1994, with the headquarters in Almaty (Kazakhstan). Its capital was formed by equal injections from each member states⁴⁴¹, and its main activities were due to ensure inter-state settlements, assist the development of regional trade, finance various projects of both regional and national significance in each state. In general, the bank financed some moderate projects (from \$500 thousand to \$5 mln. USD) in each country. It also helped economic entities from the member states prepare business plans preparatory to loans. Besides, it received grants from some foreign governments and multinational banks for its work and correspondent relations with several important overseas and regional banks.

According to the program of economic integration until 2000, a particular attention was given to creation of joint ventures in production, particularly in industrial field, given the existing potential. In machine-building complex, for instance, it was agreed upon the joint production of cable and related products, mobile compressor stations, excavators, machine and equipment for agriculture, including for melioration purposes. The Uzbek-Korean auto plant “UzDaewooauto”, with its partners from Kazakhstan and Kyrgyzstan, were reportedly to have made arrangements on intra-industry regional cooperation to produce and supply various spare parts for the given plant from economic units located in their territories. Uzbekistan expressed its willingness to take part in the completion of the factory in Ust-Kamenogorsk (Kazakhstan) was going to produce zirconium concentrate, in order to use it as a raw material in its domestic china and ceramic industry.⁴⁴²

One of the reasons to coordinate the moves towards a market economy between the states was explained by the difficulties of introduction of new currency units in each state. None of the states was in position at independence to rapidly introduce its own currency, yet a few wanted to be dependent upon monetary decisions taken by Russia. At the CIS summit in Bishkek in

⁴⁴⁰ The same.

⁴⁴¹ The four countries provided \$3 mln.USD each.

⁴⁴² Ziyamov N. Nekotorye Aspekty Ekonomicheskogo Sotrudnichestva Tsentralno-Aziatskih Gosudarstv. Magazine Obshestvennye Nauki Uzbekistan, 1999, No 3-4, p.51.

October 1992 the states agreed to maintain the Russian ruble zone.⁴⁴³ After the ruble was allowed to float and price liberalization was launched in Russia, its value immediately plunged against the dollar, while domestic prices moved up substantially. In the situation, when the republican borders were actually porous, Central Asian states had little tools to prevent significant cash movements across the whole CIS space. On the other hand, they themselves were unable to prevent extra credit domestic emissions, which formed additional inflationary pressure on domestic goods and commodities markets, still in shortage in the region.

In such conditions, Kyrgyzstan, first among the region's countries, introduced its national currency, the som, in 1993. His unilateral actions, however, were not welcomed by its neighbors, who rushed into closing up national borders to eliminate an inflow of huge amounts of cash money. Uzbekistan, for example, acted quickly to establish border and customs inspection posts along the many thoroughfares where it was possible. But it brought little efficiency and was only a temporary step before all the countries introduced their own national currencies very soon.⁴⁴⁴

In the subsequent years (1998-1999) relatively slow progress in intra-regional relations had been made. There are probably two main explanations for that: economic and political. The former was related to the fact that all the countries managed to reach some degree of domestic macroeconomic stabilization with the first signs of economic growth. It enforced some states to put through with further reforms. Yet the situation remained relatively fragile, as August 1998 financial crisis in Russia had a strong effect on Kazakhstan and Kyrgyzstan, to a lesser degree on Uzbekistan. The first two states kept up very close relations with the Russian economy, which finally ensured a spillover effect of the Russian crisis. Kyrgyzstan was already saddled with its rising external debts problems, when the crisis raised substantially the doubts on the returns from the reforms, leading the country to halt or even reverse its economic plans.⁴⁴⁵ Kazakhstan was even stronger shaken by the crisis which fuelled domestic inflationary trends. Being more concerned in macroeconomic stabilization, it was hard for Kazakhstan to ensure the committed terms on sustainable and consequent customs and transit policies with respect to its neighbors, which finally resulted in transit fees going up. Although Uzbekistan was insulated from direct impact of the Russian crisis, higher prices in

⁴⁴³ Gleason G. Inter-State Cooperation in Central Asia from the CIS to the Shanghai Forum. *Europe-Asia Studies*, Vol.53, 2001, No 7.

⁴⁴⁴ Uzbekistan implemented it in two stages: in Nov.1993-Juni 1994 temporary currency unit sum-coupon, then since 1 July 1994 – the Uzbek sum was introduced. Kazakhstan introduced its tenge in November 1993.

⁴⁴⁵ Pomfret R. Central Asia since 1991; the Experience of the NIS. OECD Development Centre Technical Paper 212, Paris, July 2003, p.36.

Kazakhstan and Russia had its negative influence on its import and export opportunities. As was known from history, if the Central Asian countries had had to face with direct economic problems, they would have preferred to act more unilaterally by favoring national interests, rather than following any common regional approach to address these problems through appropriate coordination. In addition to these economic factors, the political side of the issue is seen by some experts in that Kazakhstan and Kyrgyzstan, for fear of Uzbekistan's military preponderance and strong-arm strategies in security-related issues, held back from direct cooperation within the Central Asian Economic Community and tried to search for closer cooperation with other states in the frame of other regional groupings, such the Shanghai Cooperation Organization, or the Eurasian Economic Community, for instance, though it is rather difficult to assess the real impact of the given factor on their decisions.⁴⁴⁶

In 2000-2001, the region had to confront mainly with geopolitical issues both within and around the region.⁴⁴⁷ One of the basic trends during this period was a threat of destabilization of socio-political situation in the region after a number of the undertaken incursions of militant Islamic groups from the neighbor countries into Uzbekistan.⁴⁴⁸ It put the governments of the republics before a real threat which in turned necessiated to introduce some cordial and immediate changes both in institutional structure of regionalism, and the substance and focus of their further actions. Despite its new name in January 2001,⁴⁴⁹ the decisions was taken in December of the same year in Tashkent, and subsequently the respective Agreement was signed at the meeting of the heads of state in Almaty in 28 February 2002, to transform the economic community into the more generalized Organization of Central Asian Cooperation. It was a time when economic aspects were officially ceased to be the only issues of regional consultations and negotiations by the shifted focus on more security-related components, although political and security matters had already been on the regional agenda very often at the previous meetings too. The former "cumbersome and inefficient" institutional structure based on the regional Councils of the Heads of State, Foreign and Defense Ministers, and the Executive Committee of the Central Asian Economic Community was replaced with a new system of national coordinators from each country who are subject directly to the Presidents

⁴⁴⁶ See Pomfret R. Central Asia since 1991; the Experience of the NIS. OECD Development Centre Technical Paper 212, Paris, July 2003; Bohr A. Regionalism in Central Asia: New Geopolitics, Old Regional Order. *International Relations Magazine*, Vol.80, issue 3, pp.485-502.

⁴⁴⁷ Talipov F. *Teoriya i Praktika Regionalnoy Integratsii v Tsentralnoy Azii*, Magazine Central Asia and Caucasus, 2002, No 2, p.94.

⁴⁴⁸ See more in List D. Regionale Kooperation in Zentralasien: Hindernisse und Moeglichkeiten. Research work within the Central Asian project, pp.235-243.

⁴⁴⁹ The Central Asian Economic Union was renamed into the Central Asian Economic Community in January 2001, yet no substantial differences could be seen in its goals and activities comparing to its predecessor.

and should work more closely with the Ministries for Foreign Affairs of their own countries. Some experts characterized the given changes by that the ambitious economic projects of the past had given the way to the tasks and issues defined not by the countries themselves, but by the true life reality.⁴⁵⁰

Since 2002, the regional processes have been influenced by the incremental and broad contacts with the non-regional partners. Since then, the region was visited by so many top level delegations, especially from the USA, EU, and other bi- and multilateral organizations, which had been never ever seen during the entire period of Central Asia's independent development.⁴⁵¹ All the countries tended to pursue multi-vector foreign policies by expressing their willingness to cooperate with the USA and West in general in the military field. Equally all of them had already been the members of the Shanghai Cooperation Organization, while Kazakhstan, Tajikistan and Kyrgyzstan were also the members of the Russia's led Collective Security Treaty Organization.⁴⁵²

Besides, the most recent warming on the front of the Russian-Uzbek bi- and multilateral relations could be also seen as an important feature of the given period. But its impact is still due to be assessed in terms of the entire regional trends.⁴⁵³ By setting about refurbishing its positions in the region, Russia is expectedly to rely upon the tools of both geopolitical, economic and military cooperation. The fact that Russia has already been granted full membership in the Central Asian Cooperation Organization (CACO) may serve as an evidence of the expected changes in the regional tendencies in the years to come.⁴⁵⁴ Yet before the prospects will be debated, the challenges of the past regional development need to be analyzed.

6.2.2. Confronting Reality

6.2.2.1 Economic Constraints on Regional Efforts

The regional states had to encounter with a number of controversial processes. By retaining deformed elements of the common economic space in the first years after the demise of the USSR; having recognized and strongly believed in the possibilities to speed up local

⁴⁵⁰ Kuzmin N. Regionalnoye Sotrudnichestvo Stran Tsentralnoy Azii. Materials of the Conference "Stability in Central Asia in Post-Conflict Period", Tashkent, 2002.

⁴⁵¹ Hill F. Areas for Future Cooperation or Conflict in Central Asia and Caucasus, Yale University Conference "The Silk Road in the 21 Century", 19 September, 2002. www.brook.edu/views/speeches/hillf/20020919.htm.

⁴⁵² See more for that in List D. Regionale Kooperation in Zentralasien: Hindernisse und Moeglichkeiten. Research work within the Central Asian project, pp.180-190.

⁴⁵³ Inomjonov Kh. "Aussen und Sicherheitspolitik der Republik Usbekistan in den ersten Jahren der staatlichen Unabhaengigkeit" within the Central Asian project.

⁴⁵⁴ Gleason G. Central Asian Countries Close Ranks With Russia, Central Asia-Caucasus Analyst, 30 June 2004. www.cacianalyst.org/view_article.php?articleid=2451.

economic processes through the organizational and political methods; having plunged into the euphoria at the initial years after independence, the states appeared to overestimate the real factors of economic integration. These factors might have been essential the long-run, but turned out to be inadequately poor at the early stages so far. According to the analysts, most probably, the lath of integration came to be set up initially at the higher level.⁴⁵⁵

Therefore, the states had to face fierce, but probably some objective reality in the combination of socio-political, economic and natural factors in the new development terms. The main socio-economic factors, which subsequently exerted influence on inter-state cooperation in the past, were the following:

- national strategy of economic reforms and future prospects for development;
- national trade policies;
- difficulties in the financial field, as well as related problems with inter-state payments and non-payments;
- external shocks.

One of the main factors which influenced the lay-out in Central Asian, could be found in the differences in the approaches to both the development and implementation of domestic socio-economic reforms through the prism of future development. Despite all the states committed themselves to one common strategic goal, i.e. to build up an open market economic system with a particular emphasis on its social component, the paths the national governments chose to move towards the final goal, came to be different. Kazakhstan and Kyrgyzstan embarked on the path of radical reforms. It resulted in that very soon all domestic prices had been liberalized drastically; most part of local state enterprises had been privatized by the middle of the 1990s; and foreign trade operations had been liberalized with free account convertibility of national currencies in place. This in turn eventually allowed the two countries to open up the economies to the inflows of foreign capital and foreign assistance from bi- and multilateral resources.⁴⁵⁶

Since the key issues of the Uzbekistan's national development strategy have been already covered by the previous chapters, the emphasis will be placed on the single features to explain the differences through the prism of regional events. Thus, the Uzbek path emphasized the

⁴⁵⁵ Ushakova N. Tsentralno-Aziatskoye Sodrujestvo – Napravleniya Transformatsii, Magazine Central Asia and Caucasus, 2003, No 3, p.143.

⁴⁵⁶ Pomfret R. Central Asia since 1991 ; the Experience of the NIS. OECD Development Centre Technical Paper 212, Paris, July 2003

maintenance of local industrial capacities, full employment, rural development and diversification of the economy, which implied relatively restricted and step-by-step liberalization. While foreign direct investments were prioritized too, the strong reliance on multinational foreign aid was practically ignored. To achieve these goals, the five principles of domestic reforms, known as “the Uzbek model” was developed.⁴⁵⁷

Tajikistan up to 1997 was fully unable to make any reforms, being engaged in lasting and severe civil war. As a result, the country was turned into the poorest nation in the whole CIS space.

These general divergences laid the ground for mutual discontent very soon, since national actions to carry out reforms were understandably implemented unilaterally, very often driven by some steps to protect national interests too. For example, when Uzbekistan’s government maintained subsidies on its basic consumer goods, price for the flour in the country was used to lower than its domestic production costs. It meant that in new market terms and almost transparent national borders in the region, this flour was naturally finding its way into neighbor countries (Kazakhstan) where it could have been sold at higher prices. For this reason, Uzbekistan was to certain degree concerned in slowing the process of price liberalization in Kazakhstan down, while Russia, as a leader and initiator of price liberalization, - in urging the latter to go faster. And when Kazakhstan was unwilling to slacken the tempo of its movement towards liberalization, it provoked adequate responsive measures from its regional neighbors.⁴⁵⁸

In the frame of strategic national priorities, each country also implemented its own trade policy, which has not always dovetailed with regional interests. After the independence, practically all the countries had to deal with substantial deficits in trade balance related above all to the close integration into the former Soviet economic complex. According to some data, the former system resulted in the exceptionally high level of intra-Union trade for the region: 89% - for Kazakhstan’s trade turnover (import plus export), 86% - for Kyrgyzstan, and 89% for Uzbekistan.⁴⁵⁹ On the other hand, at the outset of 1990s, the share of net material product supplied by the other Soviet republics to Kazakhstan was equal to 39,9%, Tajikistan – 41,8%,

⁴⁵⁷ For more details see the previous chapters on economic development of Uzbekistan in the years of Independence.

⁴⁵⁸ For instance, it was probably the main reason, when Uzbekistan was forced to impose export tariffs, establish tough regulation, or simply ban some kind of exports. See: Sirajiddinov N., Gulyamov R. Sirajiddinov N., Gulyamov R. *Reforma Vneshnetorgovoy Politiki v Protssesse Liberalizatsii Valyutnogo Rynka Uzbekistana*. Magazine *Halqaro Munosabatlar*, 2001, No 3.; Gleason G. Inter-State Cooperation in Central Asia from the CIS to the Shanghai Forum. *Europe-Asia Studies*, Vol.53, 2001, No 7, pp.1085-86.

⁴⁵⁹ Michalopoulos C., Tarr D. *Trade Performance and Policy in the Newly Independent States*, Washington D.C., World Bank, 1996.

Uzbekistan – 43,2%, Kyrgyzstan – 50,2%, Turkmenistan – 50,7%.⁴⁶⁰ It meant that all the states remained significantly dependent on external supplies, especially on strategic raw materials (oil, energy products, metal) and food products. Hence, it induced to look for the stable sources of foreign exchange to keep up current domestic social and physical needs on the one hand, and to realize reforms on the other.

For this reason, all the countries reoriented their trade towards the far distant foreign markets where natural resources could have always been easily sold, i.e. Uzbek cotton and gold; Kyrgyz gold; Turkmen gas; Kazakh oil; Tajik aluminum. Therefore, in all the countries of the region the share of non-CIS countries exceeded over the half of total trade after the middle of 1990s: from 37,5% in 1994 to 60,3% in 2001 for the whole region.⁴⁶¹ In these terms, the national trade priorities, both as to the structure and geography of exports and imports were different in several aspects, which subsequently had an impact on the vectors of the geoeconomic and geopolitical interests in each state. Moreover, the economies of the region seemed to vie in investments to be attracted from industrially developed countries.⁴⁶²

On the other hand, infrastructure shortages could be of a particular concern too. Poor land, rail and air connection within the Central Asian region due to economic and historical development within the former system proved to be another major constraint on intra-regional trade. Although the railway system was a priority for development on the Soviet policy agenda in comparison with other forms of transport, the majority of such connections were developed vertically which prioritized the relations with Russia and other European republics. On the contrary, little attention was given to intra-regional linkages. Besides, the main regional roads were not only accustomed to ensure cargo traffic, but also got out of the order very soon in view of lack of an appropriate maintenance. In the new terms of post-independent development, it implied that regardless geographic proximity, the countries of Central Asia de facto remained economically secluded from each other.

⁴⁶⁰ For Russia, for instance, this figure amounted to 18,8%. See Anisov V., Babaev B. *Formy Regionalnoy Integratsii*, in Diter H. *Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.172.

⁴⁶¹ Ushakova N. *Tsentralno-Aziatskoye Sodrujestvo – Napravleniya Transformatsii*, Magazine Central Asia and Caucasus, 2003, No 3, p.144.

⁴⁶² One needs not, however, to overestimate the outcome of attraction of foreign investments. In case of Central Asia it may witness not only about particular success of national policies or favourable conditions in any country of the region, but may have been equally related to the nature of both national policies and foreign investors, given the fact that the latter look first and foremost for the easiest, short term and the most profitable fields of economy. In other words, investments tended to go into those industries in Kazakhstan, for example, the most largest recipient of FDI in Central Asia (more than 83%), which had supposed selling and privatisation of its huge energy and resource fields, to basically foreign partners. Uzbekistan's strategy, on the contrary, relied upon on foreign inflows through the establishment of joint ventures primarily in the manufacturing sector rather than in extracting industries. See previous chapter on Uzbekistan's foreign economic strategy.

The consequences were deleterious for intra-regional trade. Its volumes dropped by 1,4 times, from \$2133,4 mln. USD in 1994 to \$1579,4 mln. USD in 2000 (Annex 6.2). During the period 1994-2001, the volume of trade between the four countries as share of their exports and imports, as well as in trade with the CIS, reduced too from 15,6% to 7,2%, and from 25,6% to 18,1%, respectively. Thus, the indicator of intra-regional trade came to be much less than the same figure in other regional groupings in the world (See Table 6.1, p.233).

This situation was exacerbated by the mutual protectionist policies in each country. Non-tariff barriers emerged on the basis of imperfect national legislation and eventually resulted in cumbersome customs procedures, low regulatory transparency, the operation of transport services and corruption practices.⁴⁶³ As a result, the conflicting trade policies and non-tariff barriers inhibited the interaction of private business groups and individual traders, including those in transboundary areas, stifling their potential contribution to the creation of the autonomous interstate linkages necessary for the evolvement of informal regionalism.⁴⁶⁴

The main feature of the past efforts was the domination of state-to-state relations which are certainly important, especially in the creation of common rules and conditions and coordination of the regional initiatives. Although non-centralized contacts between the states could serve as the main force to produce substantial amounts of immediate social and economic benefits, they remained definitely underdeveloped. Direct contacts between the administrative territories and various economic units were poorly developed not only due to inadequate regional rules and legislative conditions, but also because of the differences in each country's environment. Consequently, economic units were acting in more liberalized conditions in Kazakhstan and Kyrgyzstan, while state dominance and restricted opportunities for free market behavior were more pertinent to Uzbekistan. The President of Kyrgyzstan Askar Akaev once noted as to the facing challenges over the establishment of joint international consortiums in energy and water management by saying that "*the process of the establishment of such structures proved to be a complicated process due to a different level of reformation of the economies in Central Asian member-countries*".⁴⁶⁵ This generally held for other economic units too which were devoided to behave in the equal environment, and to be therefore, similarly sovereign partners in passing mutually propitious decisions.

⁴⁶³ Bohr A. Regionalism in Central Asia: New Geopolitics, Old Regional Order, International relations Magazine, Vol.80, issue 3, pp.485-502.

⁴⁶⁴ The most recent impact on intraregional trade was seen, after Uzbekistan had introduced high taxes on retail trade and private imports to the country in 2002. As a result, only a small number of entrepreneurs were involved in foreign economic activities in Uzbekistan in 2003. According to some figures, only little more than 1% of Uzbek small and medium business were engaged in foreign trade most part of which with no doubt was made up of the regional trade too. International Financial Corporation Report, Economist, 24 July 2003

⁴⁶⁵ Magazine Panorama, 1997, No 49, p.2.

Another important issue of the complex inter-state relations was caused by buoyant debts and non-payments for the commodities supplied. The situation was especially intrinsic to the energy sector, when countries-consumers (Kyrgyzstan, Tajikistan) had difficulties to pay for the energy resources supplied from Uzbekistan due to poor capabilities to collect payments from both domestic industrial units and population. For this reason, the regional meetings of the heads of state and respective institutions included the topic of the delayed payments.⁴⁶⁶ Although inter-state debts were subsequently restructured, as well as plans were devised to coordinate the foreign economic investment and future swaps between countries, obstacles to the Central Asian cooperation still remained throughout the entire subsequent period.⁴⁶⁷

The step backward was also made, after the decision to shut down the Central Asian Bank on Cooperation and Development (CABCD) had been taken in 2002. The regional initiatives in the financial sphere were unable to set up a common system of inter-state settlements which was of particular significance to implement foreign trade operations. But the reasons for this were hidden not only in the national policy actions, though this also was the case.⁴⁶⁸ The given process was also substantially undermined by inefficient activities of the CABCD itself. Being a relatively small financial institution, some bank's modest success at a particular stage was eventually replaced by the pursuance of poor credit and investment strategy. It led in turn to low returns on allocated resources exacerbated by the emergence of increasing cases of non-returned credits and bad debts in its investment portfolio, as well as to a number of cases of malpractice.⁴⁶⁹

⁴⁶⁶ In 1996, for instance even the presidential summit was unable to relieve relations between Kazakhstan, Uzbekistan and Kyrgyzstan that had become strained due to accumulated late payments and non-delivery of gas and electricity. See: Olcott M. *Central Asia: Confronting Independence*. The James Baker III Institute, the Rise University, April 1998, p 20.

⁴⁶⁷ There were several reports with coverage on regular disputes on non-payments. Being exclusively economic dispute by substance, these tensions could be easily transformed into a political plane in Central Asia dominated by a number of other unresolved challenges, such as border or water management matters, for example. As a rule, the cut-off of energy supplies for non-payments was followed by the immediate professions and steps to take restrictive adequate measures by consumer countries, producing the main setback to sustainability of intraregional relations among the aforementioned countries. See: Alimov R. and others (eds). *Tsentralnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost*. Tashkent, 2002.p.64-67. In addition, heavily indebted small countries, such as Kyrgyzstan and Tadjikistan not only failed to pay for energy products, but also for a range of other products and services therefore proposing other countries to use barter transactions. But as history of using barter in foreign trade shows, it bears the risks of inadequate trade operation under such conditions, since suppliers will tend to abuse and overestimate the price of their products to withdraw more benefits. Being thus a suboptimal tool of payments in foreign trade, it may further fuel mutual mistrust and undermine the whole trade practice.

⁴⁶⁸ For example, difficulties due to limited current account convertibility and tough trade policies in Uzbekistan had its impact on the process of creation of the mechanism of intra-regional settlements in the past.

⁴⁶⁹ In 2002 the National Bank of Kazakhstan called off the license of the head office of CABCD in Kazakhstan due to a systematic breaches of national bank legislation and norms. This decision was soon followed by the subsequent step of the Central Bank of Uzbekistan to seize activities of its branch in Uzbekistan too in connection with elimination of the main office. Being mainly economic by substance, these reasons, however,

Such controversial developments in the field of economic, trade and financial cooperation barely ensured sustainability of foreign economic relations among the Central Asian countries. As a result, volumes of trade turnover between the largest economies Uzbekistan and Kazakhstan fell from \$422 mln.USD in 1995 to \$316,4 mln.USD in 2000, while equalled to about \$175 mln. in the first 8 months of 2003. The Uzbek exports to Kazakhstan and Kyrgyzstan in 2001 was equal 84% and 60,7%, respectively, while imports from Kazakhstan and Tajikistan - 97% and 85,8%, respectively, of the 1996 level.⁴⁷⁰ The level of production and investment cooperation was also affected with many foreseen projects left unfulfilled.⁴⁷¹

The last, but not least, the external shocks seems to have influenced regional events in the past too. Even the largest economies of the region Kazakhstan and Uzbekistan are relatively small in global terms. With share of foreign trade in GDP 85% and 60%, respectively, they remained significantly susceptible to various external shocks. Following the traditional pattern, each country reacted unilaterally to ease up these negative impacts. In particular, as it has been stressed earlier, Kazakhstan responded quickly to the Russian crisis by increasing customs duties and transit fees over its territory. Uzbekistan introduced severe foreign exchange and trade restrictions, after the world prices on its cotton and gold had dropped. These steps taken by the two potential locomotives of the regional initiatives had evidently affected the smaller economies of Kyrgyzstan and Tajikistan which depended substantially on domestic markets and infrastructure of the neighbor countries.

6.2.2.2. Non-Economic Determinants

In addition to the economic factors, poor regional developments have to be seen in relation to socio-political progress of each country; the existence of a number of the unresolved issues in

implicitly witnessed about the failure in attempt to compromise far-reaching political goals for which it was established. Lack of efficient and objective system on decision-making finally led to adverse selection and one-sided nationalization of some projects at the expense of other country-participants. For instance, out of 5 members of the Board of Directors, 3 represented Kyrgyzstan, which allowed them to favor the projects with participation of companies from their own country first. See: "Otozvana Litsenziya u Tsentralnoaziatskogo banka", www.gazeta.kz, 26 July 2003; "Tsentrobank Uzbekistana Otozval Litsenzii Dvuh Bankov", www.uza.uz, 28 April 2003; "Predsedatel Natsbanka RK Glavnoy Proble moy Bankovskoy Sistemy Kyrgyzstana Schitaet Otsutstvie Realnoy Nezavisimosti u Natsionalnogo Banka", *Panorama*, 2003 №30, August. On-line version : <http://www.panorama.kz/info/index.asp?yearfolder=2003&num=30&NumArticle=21>

⁴⁷⁰ Kuzmin N. Regionalnoye Sotrudnichestvo Stran Tsentralnoy Azii. Materials of the Conference "Stability in Central Asia in Post-Conflict Period", Tashkent, 2002, p.75; Kayumov A. Prioritetnye Napravleniya Ekonomicheskoy Integratsii v Regione Tsentralnoy Azii, the same source, p.82. In 2003 (8 months) Uzbekistan's trade with Kyrgyzstan amounted to \$53,6 mln.USD (exports – \$36,8 mln., imports – \$16,9 mln.). The same figures with Tadjikistan were \$103,9 mln., \$85,9 mln. and 17,9 mln.USD, respectively. The figures are taken from the website of the Ministry of Foreign Affairs of Uzbekistan at www.mfa.uz

⁴⁷¹ In particular, despite the corresponding Program of economic integration was reconsidered and endorsed for a few times, 27 projects of the total 53, as well as 7 out of 10 primary investment projects passed through at the meetings of the heads of states eventually lost their importance.

border and water management; and differences in common approaches to the vision of regional cooperation.

At a specific development stage, history of regional organizations in Central Asia was driven more by political considerations, with economic matters as a second background.⁴⁷² In addition, some of the researchers see nation-building policies and process of "nationalizing" regimes working towards the elimination of subnational identities "as a counterpoise to the geographical imperatives and practical considerations that argue in favor of regional cooperation, while "have also geared their efforts towards realizing national histories, upgrading national languages and creating new iconographies rather than directing them towards the reabsorption of their polities into regional organizations requiring policy of sovereignty and the formation of supranational structures".⁴⁷³

As it has been mentioned before, the Central Asian common society has been made up of the communities close to each other by their cultural and historical heritage, traditions and values. For this particular reason, both the efforts to underline regional and pursuance of national ideological conceptions were very often in place in the early years of independence. On the one hand, the idea "Turkestan is our common home" was developed by Uzbek sociologists, political scientists and historians, and actively put forward by the Uzbekistan's President to ensure an ideological basis for Central Asian unification.⁴⁷⁴ On the other hand, each of the states worked out its own ideological vision to consolidate national independence and national identity.⁴⁷⁵ Yet, all leaders "were smart enough to realize that their states were still too weak and too interdependent to allow their personal and national rivalries to undermine the overarching need for regional cooperation".⁴⁷⁶ Moreover, Uzbekistan, for example, was especially loath to politicization of the regional unions by passing over any part of their recent national independence to supranational structures. On the other hand, the development process itself through signing and the endorsement of an array of regional documents on the highest level, the expression and support for the idea on creation of free trade area or free economic space in the region could be regarded as the existence and integrity of a sustainable

⁴⁷² Pomfret R. Central Asia since 1991; the Experience of the NIS. OECD Development Centre Technical Paper 212, Paris, July 2003, p.37.

⁴⁷³ Bohr A. Regionalism in Central Asia: New Geopolitics, Old Regional Order, International relations Magazine, Vol.80, issue 3, p.495.

⁴⁷⁴ See more in Karimov I. Turkiston Umumiy Uyimiz., Tashkent, 1993.

⁴⁷⁵ It was reflected in the following national slogans who tried to emphasize the specific role of each state: Uzbekistan "as the heart of Central Asia", Kazakhstan – "as a bridge between Europe and Asia", Kyrgyzstan – "as an island of democracy and a Central Asian Switzerland".

⁴⁷⁶ Olcott M. Central Asia: Confronting Independence. The James Baker III Institute, the Rise University, April 1998, p 21.

political component with the economic principles of regionalisation. Hence, these measures would eventually turn out to some extent in less control over national autonomy.⁴⁷⁷

Once in an interview, President of Kazakhstan Nursultan Nazarbaev emphasized a democratic nature of Central Asian integration by saying that “*it rests with the peoples of Central Asia to decide on the federalization of the region*”.⁴⁷⁸ Yet it is difficult to conclude, whether these views might have been unambiguously backed up by Central Asian nations in terms of certain degree of ethnocentrism observed in the early 1990s.⁴⁷⁹

Some similar trends were reportedly to obstruct sustainable economic relations in business sector too. Among the exclusively economic explanations of such poor interrelations (lack of funds, slow growth of indigenous business due to structural and institutional adjustment in new conditions), regional cooperation in the production sector between countries underperformed because of a subjective unwillingness of businessmen to invest money in the development of the other country.⁴⁸⁰

In sum, the outcome of regional initiatives turned out to be well below than expected, while substantial part of prospective integration projects was not realized. It could be equally explained by a growing range of differences in economic interests of each state; the tempo and substance of their socio-economic reforms; lack of the agreed positions in specific policy areas (trade, finance, tariffs, price); the level of domestic economic and political liberalization; the level of integration into the world economy; as well as by the differences in political, ideological and economic preferences in the post-Soviet period. Some experts believe that these divergences have come as a result of a complex and controversial process to form domestic socio-political and state systems which has not been finished yet. Hence, until the subject of integration, i.e. state itself is in process of establishment, integration process is allegedly far from its completion.⁴⁸¹ Certainly policy measures are crucial to speed up regional initiatives. Yet it is equally true that they may evolve without state-led integration

⁴⁷⁷ Jakobeit K. Teoriya Regionalnoy Integratsii. In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. pp.9-10.

⁴⁷⁸ Quoted from Talipov F. Teoriya i Praktika Regionalnoy Integratsii v Tsentralnoy Azii, Magazine Central Asia and Caucasus, 2002, No 2, p.94.

⁴⁷⁹ Although the scale of a 1991 survey was small, nevertheless, it revealed that only one out of ten in Kazakhstan and Uzbekistan felt their countries should rely on other Central Asian countries. Roughly half preferred to “go it alone”. Quite a few others preferred to turn to Western Europe, Japan, the USA or even Russia in preference to fellow Muslim or Central Asian countries. Only ten percent said nationality would make no difference in working with a colleague. From Spechler M. Regional Cooperation in Central Asia: Promises and More Promises, praxis the Fletcher Magazine of Development Studies, Vol.XVI, 2000, p.9.

⁴⁸⁰ Komissina I. Uzbekistan i Politika Regionalnoy Integratsii v Tsentralnoy Azii, in « Uzbekistan : Obreteniye Novogo Oblika », Volume II, Russian Institute for Strategic Studies, Moscow, 1998, p.198.

⁴⁸¹ Esenov M. Problemy Mezhgosudarstvennoy Integratsii v Tsentralnoy Azii (k postanovke problemy). Rossiya I Musulmanskii Mir, 1998, No 12, p.62.

too, and probably, on a more sustainable basis. Eventually they may also accelerate the much-desired market reforms in each country.

6.2.3. Shaping the Premises of Central Asian Cooperation

After almost one and a half decade of independent development, the countries of Central Asia are still to put through with the reforms towards democratic society and an open market economy. Although they are much different from what is known as Soviet type economies due to the domestic policy measures in the past, many tasks still remain ahead.

Table 6.2. Central Asian Economies, Basic Characteristics, 2002

	Popul. (mln.)	GDP (\$bln)	GDP per capita (\$USD)	Structure of GDP (%)			FDI stock (\$)	Trade in GDP (%)	External Debt/GDP (%)
				ind-ry	agr- re	servi ces			
Kazakhstan	14,5	24,4	1668	25,2	10,1	64,7	15,354	72,6	74
Kyrgyz Republic	4,8	1,6	334	19,1	35,6	45,3	415	65,5	135
Tajikistan	6,4	1,1	187	19,3	21,1	57	162	126,6	82
Turkmenistan	5,8	na	648	50	21	29	1,163	132,7	68
Uzbekistan	25,6	9,7	308	14,1	30,6	55,3	1,332	59,6	60

Source: EBRD Transition Report 2003

The factual situation is that the states of Central Asia have formed an open type of national economies, with high share of foreign trade in their domestic product. But agriculture, extracting and manufacturing industries are similarly important in all the states by adding together from one third in Kazakhstan to almost three fourth in Turkmenistan's GDP. Among others, the light and textile industries, agricultural machine building, and the construction complex in Uzbekistan, the oil and petrochemical industry in Kazakhstan, and food and home appliances in Kyrgyzstan; aluminum extraction in Tadjikistan, played an important role in the past. Against the background of some basic economic similarities, however, the intra-regional discrepancies could be also observed. These differences came out especially explicitly in the post-Soviet years not only as a result of the mixed influence of specific domestic factors, such

as uneven macroeconomic development, divergences in the national reform strategies, or domestic political unrest, but also as a consequence of external shocks.⁴⁸²

Since the early 1990s the countries of the region have been confronting with the transition challenges stipulated by the necessity of market reforms, political transformation, and the needs for nation-building. Along these pivotal elements, it was even before the proclamation of independence that the republics had contemplated the idea of closer coordination of the efforts within the region to improve the deteriorating socio-economic situation in each country.⁴⁸³ Being embraced into the turmoil of the event across the whole Soviet space in the beginning of the 1990s, it might be expected that these processes would not be going easily and evenly in the frame of the concerted activities. Let us consider at the issue through the prism of the objective pre-conditions for regionalism in the region.

In the early 1990s, the countries' development was pre-determined by the legacy of the recent Soviet past. In particular, the structure of merchandise exports remained dependent on a few crucial commodities even almost decade later (Annex 6.3). With the cease of the subsidies from Russia in the early 1990s, all the states pushed forward national priorities to strive for the markets of non-CIS countries due to a desperate need for foreign exchange. Intra-regional trade became of less significance in these terms. Similar export structure was thus objectively more conducive to competitiveness rather than complementarity of the countries, with almost little incentive to trade with each other on the goods they could produce at home.⁴⁸⁴

These developments gave rise to some views to conclude that structural context in which subregional initiatives were taking place, were therefore, more akin to the African economies with the staple-based foreign trade, rather than to those of Europe, North America or South-East Asia, in which intra-industry trade was substantial.⁴⁸⁵ Others who interpreted regionalisation as a response to the polarizing and peripherizing pressures of economic

⁴⁸² For example, Kyrgyzstan placed an emphasis on donor-financed domestic reforms that resulted not only in relatively quick domestic macroeconomic stabilization, but also in piling up outstanding foreign debts in terms of inadequate economic growth and weak economic potential. Tajikistan's poor economic indicators came mainly as a result of internal political unrest and civil war, which actually destroyed the economic system in the country for the most part of independent development. Kazakhstan looked better in attracting higher volumes of FDI, mainly because of rich injections in oil industry, while Uzbekistan preferred to move gradually in the implementation of its policy goals.

⁴⁸³ See: Zayavleniye Rukovoditeley Rukovoditeley Uzbekskoy SSR, Kazahskoy SSR, Kyrgyzskoy SSR, Tadjikskoy SSR, Turkmenskoy SSR. Na Puti Sotrudnichestva i Progressa. Tashkent, 1990.

⁴⁸⁴ Koshanov A. Khusainov B. Integration Problems in Central Asia. Magazine Central Asia and Caucasus, 2001, No 1, p.78.

⁴⁸⁵ As in Africa, "intraregional trade intensity in Central Asia was relatively low and external trade dependence was high; trade consists of mainly agricultural and mineral products, informal trade is of great significance and there are large distortions in the market system". See: Robson P. The New Regionalism and Developing Countries, Magazine of Common Market Studies 31 ; 3 September 1993, p.334.

globalization have argued that Central Asia was one of a number of regions lying in a peripheral zone in the world system. Such zones are therefore beset by political turbulence and economic stagnation, and are caught in a vicious circle of conflict, domestic unrest and underdevelopment. According this argument, while there is an incentive for such a region to organize to avert the threat of marginalisation, the regional arrangements that develop are fragile and ineffective.⁴⁸⁶

Against such the dismal background, there are also the views to find more similarities among countries which would be crucial in tackling economic, social and political challenges in the region. After the Tsarist and subsequent Soviet ruling in Central Asia, electrification, industrialization and irrigation systems were formed here on the assumption that the Central Asian states would never be independent states. Therefore, in 1991 the Central Asian countries were confronted with the task of building sovereign entities, while being integrally linked into a common economic and geopolitical space. Nowhere were the states of the former Soviet Union more closely bound with one another than in Central Asia, not only because of the strong sense of common ancestry and shared cultural and religious heritage, but also simply because of region's geography. Precise boundaries were never drawn and highway and railway systems paid little attention to national borders.⁴⁸⁷ Besides, during the common past Central Asia acquired an interconnected power grid that was used to pool energy resources between each other.⁴⁸⁸

As the part of retained traditional energy linkages, Uzbekistan also supplied Kyrgyzstan, Tajikistan and Southern Kazakhstan with natural gas, while Kazakhstan was a traditional supplier of coal to Kyrgyz power plants. Moreover, small economies of Kyrgyzstan and Tajikistan are significantly dependent on markets of larger countries, while Uzbekistan - on

⁴⁸⁶ Hettne B. Regionalism, Security and Development : a Comparative Perspective, in Hettne B., Inotai A., Sunkel O. Comparing Regionalism for Global Development. Basingstoke: Palgrave, 2001, pp.3-5, 8-9.

⁴⁸⁷ For example, the main route between the Uzbek cities of Tashkent and Samarkand and that between Tashkent and Andijan went through Kazakhstan and Tajikistan, respectively. The Kyrgyz also must pass through customs points on the main routes between Bishkek and Osh, as well as between Bishkek and Talas (all the Kyrgyz cities), crossing briefly into Uzbekistan and Kazakhstan, respectively. Moreover, according to some Western analysts, for example, the southern part of Kazakhstan was informally closer to Tashkent, which was about 2 hours away than the Kazakh capital Alma-Ata (now Almaty), which was a 10-hour drive. Olcott M. Central Asia: Confronting Independence. The James Baker III Institute, the Rise University, April 1998, pp.17-18. In addition, it might be explained by both transparency of borders between the republics, and the fact that Tashkent was chosen as the epicentre of the Soviet policies in the entire region during the Soviet ruling, not to mention many ethnic Uzbeks who settled and lived mainly in this part of Kazakhstan.

⁴⁸⁸ In particular, Tajikistan, Kyrgyzstan and the southern parts of Kazakhstan were supplied by power energy from Uzbekistan, while Kyrgyzstan in its turn also supplied power to Uzbekistan's Ferghana Valley. Being in partial use, the grid is currently in poor state and needs upgrading to eliminate huge physical losses during energy transmission.

transit routes going through Kazakhstan.⁴⁸⁹ On the other hand, all the countries are locked with no direct access to seas, while Uzbekistan is one of the two double land-locked countries in the world which makes it extremely keen in keeping up sustainable regional linkages.

On the other hand, the necessity for macroeconomic stabilization in the countries might have provoked the latter to reorient trade towards the markets in which they could obtain foreign exchange and then cushion the balance of payments problems. Although intra-regional trade does place a small emphasis on industrial goods, the region has continued to expand its industrial potential in the post-Soviet development which included the aforementioned energy, petro-chemical, machine-building, radio-electronics, home appliances, food and textile, aviation, automobile, etc. In terms of the regional shortages in light industry products (food, textile, shoes, etc.) as well as unsustainable energy supplies, there could be still untapped opportunities in inter- and intra-industry exchange of goods and services. Therefore, these industries may have probably underperformed in the past not only due to the regional non-complementarity and lack of appropriate mutual interests. It might be equally true that they did so because of the poor institutional base, inadequate policy procedures, lack of common rules and norms, the shortage of domestic investments, and the ongoing period of complex structural adjustment during transition to a market economy.

Moreover, strong cultural and social identity of the regional communities should not be underestimated too. In this regard, some researchers from the region fairly argue that *“supporters of economic determinism refer to the lack of economic complementarity, they certainly pay little attention to a fundamental fact. It means that their economic rationalism relatively to integration is more attributable to the formed polities of the industrial and post-industrial epoch. Yet, in our case, under the general trends of regionalisation of international relations, the question is not only to draw up the Central Asian political map which has not been completed yet, so have the issues not been resolved to impinge on the completion of this process. Being historically established, a transboundary way of life of the local communities is hardly confined within the frames set up by national boundaries. Yet speaking generally, it is still far from the final understanding that delimitation is the economically inefficient*

⁴⁸⁹ In 2001, for instance, Uzbekistan was the second largest user of transit railway cargo system of Kazakhstan with more than 23% of its export and about 28% for its import. For Russia, these figures were 31% and 19%, Tajikistan - 9% and 13%, Kyrgyzstan - 5% and 7%, respectively. See: Rakhimov K. Kuda Povernnyotsya Transportniy Vektor Kyrgyzstana? At: <http://profi.gateway.kg/rakhimov3>

*situation if the costs of drawing up the true national bounds with all their attributes are going to be taken into account”.*⁴⁹⁰

By taking a look at the issue through the prism of common threats which nowadays all the countries have to confront with, such as drug trafficking, the spawning of religious extremism and fundamentalism, etc.⁴⁹¹, the opinion is dominated by security-related regionalism which is equally going to be the main driving force of regional cooperation in Central Asia in the future.⁴⁹² The President of Uzbekistan I.Karimov suggested on this occasion a new formula which defined regional efforts in the way that *“the threat to security is inversely proportional to the level of integration of the states”*. It may indirectly witness about the country’s concerns and readiness to seek for the common way to resist potential threats, as well as to set out a new platform for the joint efforts.⁴⁹³

At the same time the heads of all the Central Asian states recognize unanimously the necessity and benefits of economic collaboration which is integral part of the scientific security-related debates and a pre-condition for long-lasting and sustainable security. In particular, the President of Kazakhstan N.Nazarbaev has emphasized the rationale of such cooperation: *“If we set up single economic space, it will embrace 55 million people. If we remove the frontiers between our states and open trade routes, we shall acquire a market that will enable Central Asia to become self-sufficient, so that all the states can enjoy normal lives. Indeed, Central Asia can meet its needs in energy, fuels and foodstuffs. We will not ask anybody to buy our commodities – we shall sell them here. Can you imagine how much we shall gain?”*⁴⁹⁴ Uzbekistan’s President, added some philosophical and historical notes to these discourses. But he similarly pointed to the economic dimensions as something which had traditionally existed in Central Asia for centuries of its development: *“This integration by its substance was and remains popular... Let us stress that integration of the peoples of Central Asia is not a dream or project for the future, it is something which exists, it is reality which requires organizational and political forms only”*.⁴⁹⁵

⁴⁹⁰ Talipov F. Teoriya i Praktika Regionalnoy Integratsii v Tsentralnoy Azii, Magazine Central Asia and Caucasus, 2002, No 2, p.90.

⁴⁹¹ For more details on these issues see List D. Regionale Kooperation in Zentralasien: Hindernisse und Moeglichkeiten. Research work within the Central Asian project, pp..

⁴⁹² See the International Conference “Stabilnost v Tsentralnoy Azii v Post-Kofliktniy Period”. 14-15 July 2002, Tashkent. Materials of the Conference “Stability in Central Asia in Post-Conflict Period”, Tashkent, 2002.

⁴⁹³ Karimov I. Uzbekistan is on the Threshold of XXI Century: Threats to Security, Conditions of Stability, Guarantees for Progress”, Tashkent, 1997.

⁴⁹⁴ Quoted from Talipov F. Theoretical Aspects of Central Asian Geopolitics. Magazine Central Asia and Caucasus, 2001, No 6, p.133.

⁴⁹⁵ Karimov I. Uzbekistan is on the Threshold of XXI Century: Threats to Security, Conditions of Stability, Guarantees for Progress”, Tashkent, 1997.

In the confirmation of his words, many regional scholars are also close to the view that the unity among the nations in Central Asia is believed to be a key task with the solid prerequisites based on common culture, traditions, way of life, social values, and similar languages. Thus, it might serve as a strong psychological aspect in bringing the regional nations much closer to each other even without the costly policy-led projects to encourage desired regional linkages.⁴⁹⁶

On the other hand, in the last decade the region was warped by internal regional conflicts whose roots had been mainly entrenched in the Soviet time. Along the tasks to build up and consolidate the acquired independence, it was then sometimes the case that each state had formed a set of more or less efficient means to exert an influence on interstate relations across the region too in order to protect its national interests.⁴⁹⁷ This certainly did not contribute to the parallel efforts towards regionalism. Yet, in new terms these conflict areas could be equally treated as a ground for the hidden and unrealized potential for regional cooperation, since it may help to reach the double effect: firstly, promote conflict prevention and peace in the region; secondly, economic benefits and sustainable development. Thus, it is one problem with two alternative choices of its solution: to conduct the concerted movements to a common solution, or keep on acting unilaterally. If the benefits and costs of political and economic cooperation are set out correctly to turn negative factors into mutually acceptable rational ideas, then desired progress could be most probably made. But key question is how to specify the share of each possible factor to have impact on Central Asian regional trends in the past and in the future.

In seeking for different pre-requisites for the desired unity in the region, scholarship and officials usually attempt to bring the states under the common denominator of cooperation. As scrutinized below, first efforts on comprehensive economic integration in the region failed to reach their goals due to both the intra-regional problems and external factors which threatened national security. It may partly explain, why security-related agenda had been brought to the forefront of regional collaboration. However, one needs to be emphasized that economic dimensions may play an equally important role to consolidate Central Asian unity and cooperation. It certainly needs to be well devised and implemented, since traditional economic links across the regions suffered significantly in the last decade. Yet if they are revived and

⁴⁹⁶ Kasenov U. Post-Soviet Modernization in Central Asia : Realities and Prospects, in Rumer B., Zhukov S. (eds) *Central Asia: The Challenges of Independence*. M.E. Sharpe, New York, 1998, p.51; see also Talipov F. *Theoretical Aspects of Central Asian Geopolitics*. Magazine *Central Asia and Caucasus*, 2001, No 6

⁴⁹⁷ See, for example, Giese E. and oth. *Zwischenstaatliche Wassernutzungskonflikte in Zentralasien*, Zentrum fuer Internationale Entwicklungs- und Umweltforschung, Discussion Paper No 18, Giessen, Mai 2004.

fostered by appropriate policies and regional initiatives, the fruits of cooperation may be substantial. It is uncertain, how much time it may take to make all these arrangements for appropriate policy conditions to be set up. But there is a little doubt that if common and harmonized regional policies would be followed, the region's priorities might be addressed in a better way.

For these reasons, it seems to be relatively early to be conclusive over the poor impulses for economic collaboration due to the insufficiency of objective economic determinants of regionalisation, such as the similar level of economic development, complementarity, intra-industry trade, etc. Economic complementarity is not a static situation which means that it may change if the regional union expands due to new members, including those more complementary to old members. In addition, it could be equally argued that success or failure of regionalism may depend on not purely economic issues too, such as administrative barriers, inter-state conflicts, political will, vested interests in each country, ongoing reforms, social and cultural values, etc. The question remains open, however, what might be more important to regional trends: economic incentives, or adequate socio-political environment.⁴⁹⁸ Central Asia is obviously a region with so far the stifled intra-regional potential for joint projects which could be still realized. This is also strengthened by the necessity to gear efforts on resolution and cooperation in pursuing conflict prevention and security potential strategy. The key issue on the agenda may be not just about the expediency and objective conditions for cooperation, but to search for the areas, methods and ways of its implementation. In defining them more specifically, several possible scenarios of the future development might be helpful.

6.3. The Scenarios of Prospective Regional Trends in Central Asia:

Priorities, Forms, Nature

6.3.1. Determinants of the Scenarios

The regional resurgence of 1990s in Central Asia has presented the states and their governments with an ongoing dilemma interesting to scholarship: how do they reconcile the need, on one hand, to liberalize and coordinate their economies and political systems to prevent greater marginalisation, with the perceived exigency, on the other hand, of

⁴⁹⁸ International experience also gives no explicit evidence of such interrelationship. The EC was founded for political reasons, but economic integration was given the key functional role, although a number of issues (CAP, monetary union) were pressed by virtue of active political tools. In North America, both economic and political factors prompted controversies in bilateral economic relations since XIX century. But on some stages (since 1965), bilateral trade was ever increasing regardless of deteriorating political relations between two countries over some decades. See more in: Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.347-253 and pp.390-402.

consolidating and maintaining their power bases?⁴⁹⁹ In such conditions the security and economic challenges facing the Central Asian states are expected to reinforce each other with a particular impact on further regional cooperation. It is this dilemma that at least may partially explain why regional structures have survived for years in Central Asia while barely functioning, yielding only meager results and limited achievements. At the same time the level of their interdependence and mutual influence is going to determine a character, form and priorities of the future developments within the region.

In this regard, it is an attempt to devise some conditional scenarios for regional economic trends in the future, yet the timeframe of their realization is open to debate. Moreover, based on the outcome of the previous regional efforts, the given scenarios are expected to depend on peculiar socio-economic processes in each single country; economic characteristics of the countries given their potential similarities and differences; regional interdependence; as well as by the extent of involvement of regional and non-regional powers in the events to take place in Central Asia. The scenarios do not seem to follow a quite different paths. Much will depend on what kind of priorities, either economic or political, the countries would prefer to bolster up. Thus, possibilities for the various theories applicable to both sovereign and common regional development also need to be discussed.

6.3.2. Features of the Scenarios

6.3.2.1. Economic Bilateralism vs. Multilateral Cooperation

The first scenario is based on the assumption that the Central Asian states would continue to develop in terms of poor economic complementarities and similarities in economic and export structures. Therefore, despite of the signed inter-state agreements in the past, they would provide no or little impetus to speed up regionalisation due to little interests in a single market as in the EU, nor capabilities to secure large investment resources from one of the member states, as in NAFTA.

Given relatively poor signals proceeding from economic factors across the region, further development of the economic union here is expected to stumble. Consequently, one may also expect that the countries may keep on economic cooperation with each other on a bilateral basis, while no particular partner in the region is given preference. Rather, the countries will try to seek most-favored-nation treatment and membership in multilateral organizations, such

⁴⁹⁹ Bohr A. Regionalism in Central Asia: New Geopolitics, Old Regional Order, *International Relations Magazine*, Vol.80, issue 3, p.494.

as the WTO, along with loans, technical aid, and investments from national and multinational sources. The so-called “export globalism” may continue which implies that the countries would go on with the orientation towards markets beyond the region.⁵⁰⁰ In other words, the countries will remain main exporters of raw materials and commodities, and dependent on the imports of capital and consumer products at least in the foreseeable future.

The realization and further fate of the given scenario will be basically determined by the decisions taken by the two largest economies of the region, Uzbekistan and Kazakhstan, while the small countries, like Kyrgyzstan and Tajikistan will probably either follow this strategy or seek the more palpable support in other regional groupings, such the Shanghai Cooperation Organization (SCO) or the Eurasian Economic Community.

Despite the much shared background with common initial conditions, all the countries, especially the two larger economies, are expected to move further along different trajectories in view of even stronger sovereign positions on national socio-economic and political reforms. While smaller economies of Kyrgyzstan, Tajikistan, and Turkmenistan in perspective will remain minor players in the global economy, both of the larger countries could become significant middle-size economies, but rather in their own right rather than as part of Central Asia. In terms of further divergent economic characteristics, it is reasonable to expect that it will become an even more elusive idea to implement regional integration in the future given only moderate success made nowadays with much more contributing similarities.

With little incentives for common economic projects in the region, the Central Asian regional structures may nevertheless survive to enhance more political and security-based cooperation in collaboration with other similar regional set-ups, such as the SCO, for example. Paradoxically, but in order to pursue sovereign national development and consolidate their independence, it will require from the states multilateral collaboration to address the issues related to border disputes, intra-regional migration, religious fundamentalism, drug trafficking. It means that the theory of neo-realism may be more applicable to the region to maintain regional cooperation as a common response to external threats to national and regional security, rather than through an inadequate economic rationale with independent

⁵⁰⁰ Spechler M. Regional Cooperation in Central Asia : the Middle Road. Analysis of Current Events, 9,12 December 1997 in 1-4 ADB Regional Cooperation in Central Asia, DAI, 1998. Reference in Spechler M. Regional Cooperation in Central Asia: Promises and More Promises, praxis the Fletcher Magazine of Development Studies, Vol.XVI, 2000.

social and business networks.⁵⁰¹ This sort of cooperation could eventually circumscribe each country's autonomous development.

Among negative consequences of the scenario for the region in general and for each country in particular are the risks to remain mainly as the suppliers of commodities to the world markets with accordingly low efficiency and/or inability to improve their economic and export structure by producing more valuable finished goods. Hence, long-run sustainability and economic progress remain hardly attainable. This in turn will not only reduce economic and social benefits from foreign trade provisioned that it keeps on playing crucial role for each country in the future. This will also reinforce the states' vulnerability to cyclical global shocks, with subsequent pressure on local socio-political and economic patterns.

Besides the given strategy could promote little in both the efficient use of natural resource base of the region, and the enhancement of potential investment inflows. Most probably, the latter will be attracted primarily to finance the projects on self-sufficiency, economic viability of which could be in turn questioned. The region itself could therefore remain significantly dependent on the non-regional imports, which would further exert its pressure on the national balances of payments in terms of the limited foreign exchange earnings. Yet, the major constraint reflects in that it would be barely possible to find optimum solutions to regional infrastructure projects, since the required multi-national cooperation will be replaced by the emphasis on those projects which may be primarily beneficial to national interests rather than those of the region.⁵⁰² As evident from the past, this approach could be more resourceful in terms of both time and funds needed for the implementation of the foreseen multi-billion projects.

6.3.2.2. Common Interests and Common Projects: Huge, but Untapped Potential

Another scenario, more beneficial to our mind, is based on the postulates of the functionalist theory of regionalism which supposes to look for common points of interaction to bring together inter-state interests in particular projects or fields of economy. It is believed that this is an important step confined not only to a narrow success within the implementation of such projects, but on further moves towards much wider cooperation in other areas too. Such areas

⁵⁰¹ Bohr A. Regionalism in Central Asia: New Geopolitics, Old Regional Order, International Relations Magazine, Vol.80, issue 3, p.499-500.

⁵⁰² Alimov R. and others (eds). Tsentralnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost. Tashkent, 2002, p.64.

of the economy where the Central Asian countries share common national interests, could be the fuel and energy complex, transport infrastructure, and trade.

Unlike the former scenario, the given variant proceeds from the assertion of close economic interdependence of the countries in each of the aforementioned spheres. It is especially true for energy and transport infrastructure. Since the Soviet times all the countries are members of the Central Asian Interconnected Power Grid through which substantial exchange of energy between countries may be carried out. The centre of the grid is located in Tashkent and is responsible for coordination and monitoring of sustainable energy transmission across the region. During the last decade, however, the system has deteriorated; electricity lines are barely meeting growing consumption needs of the regional economies, while regular losses of power during its transmission has acquired a normal practice in recent time. As a result, some countries currently face not only a deficit of energy resources for domestic needs, but also suffer from its underdeveloped export potential in the given field. For this reason, the regional energy infrastructure may benefit substantially from up-grading and renovation which could for sure be able to increase efficiency of production in the energy complex of both the region and its countries.

After the 1990s Central Asia became known in the world mainly as another promising region with abundant hydrocarbon reserves. Similarly, however, only a handful of pipeline projects have been realized to bring these resources to the world markets. The region remains significantly remote and dependent on poor transport and pipeline infrastructure, while the factor of distance is one of the major impediments to Central Asian competitiveness on global markets (Annex 6.4). The main routes still basically go towards the northern direction, as in the former Soviet Union, although possibly huge benefits are untapped so far from diversification of the routes toward East, South and West. Unfortunately private investments usually come in the region in order to maximize their profits and short-term benefits, while the Central Asian states are more concerned in addressing strategic tasks to pursue domestic reforms and ensure the development of diversified foreign economic relations.

In such terms, the states could be interested in pushing forward and defending their interests together. Besides, in favor of this scenario could also speak the fact that the economies are differently endowed with natural resources: Uzbekistan has huge gas reserves; Kazakhstan – oil and coal; while Kyrgyzstan and Tadjikistan have a great potential for production of hydroelectricity (Table 6.3).

Table 6.3. Projected Energy Surpluses and Deficits, by Country, for 2005

Energy Form	Kazakhstan	Kyrgyz Republic	Tadjikistan	Uzbekistan
Oil	Surplus	Deficit	Deficit	Surplus
Gas	Surplus	Deficit	Deficit	Surplus
Electricity	Deficit	Surplus	Surplus	Surplus
Coal	Surplus	Deficit	Deficit	Deficit

Source: ADB

Through the reinforcement and extension of these linkages by regional forces, one may not only satisfy domestic needs, while effectively using regional mineral base. It would also allow Central Asia to become another stable source of energy located in the epicentre of the growing industrial needs of China and South-East Asia to the East; the extended EU to the West, and vast energy consumers, such as India and Pakistan, to the South.

In terms of importance of trade in intermediate and finished goods for the viability of a regional bloc, Central Asian economies have already formed some domestic industrial potential too. Automobile industry, radio and electronics, home appliances, light and textile industries in Uzbekistan; oil and chemical, electro-technical and machine-building industries in Kazakhstan; foodstuffs, device, and home appliances in Kyrgyzstan may jointly provide a fertile ground for inter- and intra-industrial collaboration. The large-scale industries, like the automobile one in Uzbekistan, are currently operating explicitly below its total production capacities, with little benefits from the economies of scale. Cooperation in the given sphere could thus imply the establishment of joint ventures with Kazakh, Kyrgyz and Tadjik enterprises which might specialize in spare parts, such as tyres, seats, car glasses, etc. for the head plant in Uzbekistan. In doing so, given inter-industry trade is the fastest growing type of trade among advanced economies around the world, it will allow for consequent improvement and diversification in export structure of the whole region. It will also promote innovation, cost-reduction and management efficiency in many industries, so that they further sustain efficiently in the global and regional markets as well.

In May 2004, the Presidents of the two largest regional countries, Uzbekistan and Kazakhstan, met in Astana to discuss the current setbacks in the relationship of their countries. After that meeting, the Presidents agreed to set their governments to make out the measures on “significant increases in the mutual trade turnover and the elimination of impediments on the way to its expansion”.⁵⁰³ The question remains, however, whether this meeting could virtually become that much-needed momentum in pushing regional initiatives. Nevertheless, concerted

⁵⁰³ The National Information Agency of Uzbekistan, www.uza.uz, 28 May 2004

efforts to pursue common tariff and custom policies which may eventually result in deprivation of tariffs, unification of trade regimes, and dismantling other trade barriers will unconditionally serve to foster intra-regional trade. It is important that by opening up national borders and eliminating cumbersome customs rules, bribes and bureaucratic procedures, the countries could reduce currently relatively high transactions costs, especially significant for the private sector which then acquires an excellent opportunity to contribute substantially to the development and expansion of intra-regional trade. Enhancement of trade in the border areas, for example in the Ferghana Valley, where most of the countries have common borders, is able to produce spill over effects for higher trade in other regions, too. The lessons from international experience show that “bottom-up” and private investment-driven regionalism may have much more substantial positive effect on the extension of regional relations than “top-down” and policy-led initiatives. It is also applicable to Central Asia where historically there had been no borders among the countries for the most part of its past development. In addition, since the regional governments have been declaring to stand by their further economic and political liberalization, “from below”, efforts could acquire their particular meaning.

To ensure realisation of the aforementioned measures, an appropriate transport infrastructure also needs to be built up. The specific geographical location and historical development made the region relatively distant from major world markets. All the countries are land-locked, while Uzbekistan is double-landlocked which means that the countries may be desperately interested in searching the most optimal ways to relieve and improve their situation (See **Box 6.1**).

Uzbekistan and the other regional countries participate already in existing and planned regional transport projects, such as in TRACECA (Transport Corridor Europe-Caucasus-Asia) financed by the EU Commission⁵⁰⁴; Serakhs-Tedjen-Mashad operating railway line which brings the region to the Iranian seaports to the South; the Uzbekistan-Afghanistan-Pakistan road project to the Pakistani seaports Quetta and Karachi; the Andijan-Osh-Kashgar railway and road project⁵⁰⁵ which starts in Uzbekistan and then goes through Kyrgyzstan, further to

⁵⁰⁴ The TRACECA Program, initiated by the EU, takes its origin from the Conference of Trade and Transport Ministers of Central Asia and Caucasus, which was held Brussels in 1993. The Summit of Europe, South Caucasus and Central Asia was held in Baku in 1998. The Principal Multilateral Agreement on a Europe-Caucasus-Asia transport corridor was signed at this summit. Cargo transport in Central Asia and Trans-Caucasus made up 128.5 million tons in 2003. Annual growth of cargo transport by railway accounts for 9-10%, and by road, 18-20%. Interview with R. Yunusov, Deputy Prime Minister of Uzbekistan, <http://www.internationalreports.net/asiapacific/uzbekistan/2004/deputy.htm>

⁵⁰⁵ With the opening of tunnels in 2000, and 100 kilometers of road crossing the passes of Kamchik and Rezak in Ferghana Valley (Uzbekistan), which were the most difficult part of the Eurasian transcontinental highway,

China and across its territory to the Chinese ports in the Pacific region. These are only a few of the dozen alternatives which may unite the national interests of each country and encourage them to move towards further coordination of their efforts in this field. For this reason, all the countries may stand together to support each other with being interested in a quick realization of similar projects which benefit all parties.

Box 6.1. National Transport Priorities of Uzbekistan

In an interview, Vice-Prime-Minister responsible for the Transport-related issues in the Government of Uzbekistan, pointed out a great significance of regional and international transport projects for the country. In particular, he emphasized that *“the need to cross a number of borders, the remoteness of seaports, high transport rates, the existence of physical and nonphysical barriers that isolate Uzbekistan and other Central Asian countries from world markets, constrain the growth of exports and aggravate the problems of development. At the same time, Uzbekistan has a significant geopolitical importance. Uzbekistan is located at the center of the Great Silk Road that has connected the East with the West for many millenniums. The country is located in the center of regional and inter-regional corridors that have been formed during the last 13 years. President Karimov proposed in 1989 that overcoming transport isolation and development of international transport communications become national priorities”*.

The following tasks were prioritized under the national priorities in the transport sphere:

- integration of national transport corridors into the ITC system, first of all, into the pan-European transport networks;
- use of the convenient geopolitical location of the country for attraction of transit on Asia- Europe and North-South itineraries;
- ensuring national interests in the regional transport and in the framework of globalization, including transport services;
- attracting large foreign investments;
- applying advanced world experience in the field of transportation systems, transport infrastructure, and ITC in Uzbekistan;
- sustainable growth of transit flows and currency inflow from transit by the foreign policy;
- working out maximal diversity of export and import directions of cargo transports by means of foreign policy;
- foreign policy assistance to achieve preferences in the field of tariffs and transit duties;
- search for alternative routes in order to assist cargo delivery in the shortest distances with minimum transport costs;
- ensuring interests of national forwarding agencies and transport companies in the international market of transport services, and assisting the growth of personnel and intellectual resources in the field of transport and communications by means of foreign policy;
- developing a transport system in harmony with the environment, and reducing the negative influences of transport on environment and public health.

Source: «International transport has top priority for doubly landlocked country». Interview with R.Yunusov, Deputy Prime Minister of Uzbekistan

The general rationality of this scenario is in that all the countries perceive the necessity and possibility of benefits which they can draw out from the realization of concrete investment projects in particular areas. The regional market of Central Asia may experience slow, but sustainable progress. As a result of joint measures, prospective economic union of the states

Uzbekistan has got an access to the Pacific Ocean. Now, the largest strategic international highway in Asia, passing through Uzbekistan, Kyrgyzstan and China to Chinese seaports, has begun to operate.

will probably reach the level of certain harmonization of economic, financial, trade and social policies after success has been gained in specific areas. In this regard, the role of Uzbekistan is of particular significance in ensuring this success owing to its position linking the countries of the region as well as its desperate interests to have access to the world markets which in turn is substantially pre-determined by success of the regional initiatives. Against the background of the reinvigorated and reinforced economic projects political and security dimensions might also be further strengthened.

Equally, however, there are a number of constraints in the given model. The experience of these states with little more than a dozen years of independence is too brief to foretell confidently their real potential for regionalism in ten or even five years' time. In other regions of the world, functional cooperation in one field has often preceded and helped to prompt functional cooperation in another; security policy ties may follow the coordination of economic and trade issues, for example, or vice versa. Soft regionalism has also developed as societies and political systems have evolved and transnational networks have increased.⁵⁰⁶

Moreover, this scenario is hardly realizable by the efforts of the Central Asian states only. On the contrary, it may require both, financial support and reasonable mediation from the outside. It is unlikely, that even when joining forces within a common regional union, the region will turn itself into a key player on international arena. Rather, what may be anticipated is that this union is needed to a greater extent for the development of common strategy and position on a various range of international issues, including bi- and multilateral negotiations with foreign investors and donors who prefer to see the region as a whole in the course of active regional interaction, rather than single progresses in each economy.⁵⁰⁷

In other words, the single states of Central Asia are unable to espouse real hopes for economic and political achievements, notwithstanding this contention finds little countenance among the regional scientific sets. Even the economies of the largest regional countries, like Uzbekistan and Kazakhstan, are rather small in global dimensions. The single regional economy is still unlikely to represent a large economic bloc.⁵⁰⁸ There are only two alternatives ahead for the small economies of Kyrgyzstan, Tadjikistan and probably Turkmenistan in the prospect, either to be confronted with sustainable growth of poverty, or with regional integration. It is obvious that the region should not choose between regional cooperation and integration into the world community. Successful regional cooperation could be seen as a minimal condition

⁵⁰⁶ Allison R. *International Affairs Magazine*, 2004, Vol.80., issue 3, p.426.

⁵⁰⁷ Alimov R. and others (eds). *Tsentrlnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost*. Tashkent, 2002, p.67.

⁵⁰⁸ It is comparable with the economy of neighboring Iran.

for any efforts to integrate in the world economy for at least a number of reasons, including that no country has a direct access to the sea. Consequently, further enhancement of regional trade in goods and services will be apparently dependent on the realization of concrete investment projects in particular areas, including infrastructure, trade, and energy at the outset of such steps.

6.3.2.3. New Constitutionalism in Central Asia?

The Russia's full membership in the Central Asia Cooperation Organization after the October 2004 summit of regional states has marked a new stage in the regional events. Hence, it has opened another potential scenario for Central Asia's regional prospects. Some time earlier, the President of Russia called upon the Russian diplomatic missions on more active and consequent efforts to reinforce Russian policies in the CIS space by giving an appropriate support to interregional integration trends there. Russian diplomats have got an explicit signal and responsibility to look at efficient leadership in the region through the prism of permanent adequate and effective policy actions. On the contrary, the former misguided view on a Russia's allegedly exclusive right on regional engagement in the past was severely criticized.⁵⁰⁹

Nevertheless, there is some doubt that Russia has ever completely pulled out of the region. At least, both, economic and political factors might hardly allow doing in such a way. Economically, it proceeds from infrastructure interdependence between Russia and Central Asia. The highways, for instance, have never been especially good in Central Asia, while geographically they were not connected to main world roads, or to the main regional waterways, but only to European Russia. The principal highway and rail links to Europe from Central Asia still go through Russia, although improved transport links from Europe to Asia through the region to China and other East Asian nations could be of great interest to many parties. First improvements to the road and rail links in different connections were started, towards west, south and east, and, will still be a long-lasting process. Therefore traditional routes will probably keep on playing the main role in the nearest future.

On the other hand, Russia remains a primary trading partner for all the Central Asian countries, as well as their important market for many their commodities. Geographically, Russia is too large and the Russian minorities are all spread across the whole region

⁵⁰⁹ Address of President of Russia V.Putin at the Plenary Session of the Russian Federation Ambassadors and Permanent Representatives Meeting, Moscow, Foreign Ministry, 12 July 2004, http://president.kremlin.ru/eng/speeches/2004/07/12/1323_74425.shtml

protection of whose interests is among the main Russian policy priorities. Russian domestic social, political and economic changes are well perceived in the Central Asian elites and societies whereby the Strategic Partnership Agreement of Uzbekistan with Russia has brought forth particularly warm welcome in Uzbek society which may provide necessary public support for coming closer at all levels. Thus, the strategic interests of Russia's involvement in the regional processes have dovetailed with the strong economic and socio-political roots going mainly into the common development in the past.

The given scenario is not going to be much different from the previous one in terms of regional priorities: the necessity of regional initiatives in energy, trade, and transport and communications system.⁵¹⁰ The question only is if their implementation is expected to come under big influence and even direct participation of Russia. Whereas almost all the Central Asian states have confirmed their strategic partnership with the northern neighbor⁵¹¹, they may anticipate the latter to play a role of a regional locomotive to bring all the countries together by the improvements in regional network.⁵¹²

Along with security and political issues, Russia has already demonstrated that it is going to be fairly active in the economic arena too, especially in the energy and trade areas.⁵¹³ For example because there is a lack of sufficient export pipelines out of Central Asia so far, due to either long-lasting negotiation processes, or differences in costs and forms of investments with foreign partners, or other geopolitical trends, the Russian energy pipeline system still feeds significant amounts of Central Asian oil and gas to the world markets, mainly from the most abundant countries of Kazakhstan and Turkmenistan. Russia, in its turn, is also concerned in ensuring competitiveness of its pipeline system and not allowing other alternative projects to undermine its work through functioning below its throughput capacities. Russia benefits from transport fees and will further secure the interests of its companies working in any part of the world, including Central Asia. In particular, the Russian

⁵¹⁰ At the same time, this scenario has much to do with the enlargement of the purely economic bloc, both current and prospective. At the moment, the events will be analysed through the prism of the Russia's membership, but further expansion, collaboration or even possible mergers with similar regional groupings in the longer run may equally occur. Since these unions are all in process of formation, it is difficult to predict such developments at the contemporary stage.

⁵¹¹ In its August 2004 session, Parliament of Uzbekistan ratified the Agreement with Russia on Strategic Partnership signed on October 21, 2001 in Moscow. See: Parliament Uzbekistana Ratifitsiroval Dogovor o Strategicheskome Partnerstve s Rossiey. Information agency "Kabar", 28 August 2004.

⁵¹² According to the signed Agreement between the Government of Kyrgyzstan and Russian Energy Company RAO "EES" in August 2004, Russia pledged to invest about \$2 bln. USD in completion of construction of Kambarata's two big hydropower stations in Kyrgyzstan. Being the largest company's investment project abroad, the given deal may give the Russian company not only purely economic benefits from regional export of energy, but also have a substantial impact on regional water resources management and distribution issue in Central Asia. See Siluyanova P. "Chubays Prishyol v Kyrgyziyu", www.gzt.ru. 23 August 2004.

⁵¹³ See Chapter IV for more details.

companies Lukoil and Gazprom have committed to invest up to \$1 bln.USD each within the next 35 years in the development of oil and gas fields in Uzbekistan, as well as into the improvement of domestic infrastructure. Considering them as a first large project in the energy area, Uzbekistan is plotting to boost domestic gas and oil production, while Russia has pledged to upgrade the existing regional gas pipeline “Central Asia-Centre” which eventually brings Turkmen and Uzbek gas to the Russian refineries. Kazakhstan is also expected to benefit from these plans, since a branch of the given pipeline starts in the Bukhara-Khiva gas region in Uzbekistan and leads also to Kazakhstan’s southern territories through the Kyrgyz capital Bishkek. Renovation of the existing pipeline may provide sustainable gas supplies within the region and prevent the shortage of energy which is currently observed in some parts of the region due to a poor physical state of the regional energy system.

Russia may also contribute to restoration and improvement of the road, rail and other transportation and communication links, in addition to more concessive and concerted custom, tariff and transit policies which will reflect broad interests of the land-locked regional countries into the CIS and other regional markets. In particular, Russia is a part of the Soviet-era international North-South freight transportation corridor from Europe to Iran and India through Central Asia (Kazakhstan-Uzbekistan-Turkmenistan). Another effective continuation of the transport corridor to the West, the direction China-Kyrgyzstan-Uzbekistan-Kazakhstan-Russia-Ukraine and further through Poland to Germany by an European transport corridor is considered.⁵¹⁴ Being among the Uzbekistan and Russian regional strategies in the 21 century, it may facilitate regional efforts of the regional countries to gain additional access to the seaports of Iran and India in the Indian ocean as well as to European markets in the West.

In general, Russia and Central Asia may share common interests in permanent improvement of the technical state of their air and rail park; agricultural machine-building; textile and food industries, while harmonization of economic policies will promote further benefits from expected freight volumes in both directions to Europe and South Asia.

Along with economic priorities, Central Asian economies will apply a common strategy to oppose the regional threats to regional and national security. With such collaboration under a security umbrella embracing existing initiatives within the Shanghai Cooperation Organization, the Conference on Interaction and Confidence-Building Measures in Asia, Collective Security Treaty, one may thus reach a multi-level interaction on security issues complementing each other in a much wider geopolitical area.

⁵¹⁴ «International transport has top priority for doubly landlocked country». Interview with R.Yunusov, Deputy Prime Minister of Uzbekistan, <http://www.internationalreports.net/asiapacific/uzbekistan/2004/deputy.htm>

In a row with the aforementioned benefits, the realization of the given scenario may also hold a number of specific costs of a largely long-term character. By recalling similar models in the other world regional development, it may be revealed that in order to have economic cooperation be a success, national interests of the countries should be accompanied by a concurrent or at least cohesive vision of strategic relations in the political area too. In our case, by playing a substantial role in the development of the energy and transport projects, including the small Central Asian economies, Russia will understandably proceed from its own strategic national priorities. Through a number of the concluded agreements on strategic partnership with the Central Asian states, Russia has taken a steady stand to be engaged in any large energy and transport projects of the region with the third countries. In other words, the regional countries are expected to stand on preliminary coordination of their diversification strategies with their northern neighbor which will barely allow to put into life the ideas at the expense of its own. On the contrary, Russia may be the least concerned party in any strong diversification of the regional network, capable to dwindle the use of its own routes. Moscow has pledged to promote the much-needed improvement in regional energy pipelines, but only those traditionally ensuring northern connections. That implies that horizontal economic relations in the foreseeable future and later on remain mainly unchanged; while northern links are intended to be further reinforced to keep up strong vertical interdependence.

It bears the two principal implications for Central Asia. On the one hand, the region stays close to the realization of a number of projects in particular economic areas. It is going to be easier and more cost-effective for the countries to restore and upgrade the existing infrastructure, especially if it is congruous with the Russian interests to render all necessary support for such projects. Then, it seems to make economic sense, primarily for the region. For a large country, like Russia, entering into cooperation agreements with small countries, the economic costs are likely to be minimal in terms of GDP, but for smaller economies of the region the economic benefits may be unambiguous and possibly large with respect to GDP. Although there might be no economic benefits or they are relatively small to the large country, this type of arrangement offers a low-cost method of achieving political goals.⁵¹⁵

⁵¹⁵ In this regard, political economy helps some authors point at the variance in political objectives for large countries with subsequent conclusions that these objectives most commonly involve spheres of influence. International experience refers to the EU's preferential arrangements with African and Mediterranean countries (the 1975 Lome Convention) to strengthen those countries' traditional political links with Western Europe, and the similar 1982 US initiative towards Caribbean countries. In this cases, foreign economic policy in general and trade policy in particular was foreign policy, because suggested trade preferences and favorable environment to a small trading partner assist in strengthening its economic and trade links to the large country, for which they may be a low-cost influence-strengthening tool, albeit this is going to depend on the efficacy of this and other tools in

On the other hand, in compliance with the theory of constitutionalism which among other things also supposes that smaller states are forced to follow the rules and standards of larger economies,⁵¹⁶ the regional economies will be expected to bring their standards in concert with those of Russia. It may leave little room to look for and put into life other possible justified economic and political alternatives.

Besides, implementation of new projects is much more a long-lasting process which starts with looking for potential investors and leads to the beginning of the operation. Although it is likely to be of higher priority, such projects may sustain only long after their realization under a few exogenous conditions. However, more sustainability and national security development in the long-run may speak in favor of this time span.

Therefore, it is most likely that the regional states should compromise the particular aspects of this model by taking into account possible economic and political consequences. For this a balanced and multifaceted analysis in drawing up their actions within this variant would be advisable. Yet it is often difficult to make these appropriate estimates as to various policy areas, as well as to define, whether they might serve the true interests of the countries' long-run development.

6.3.3. General and Specific Constraints

Central Asia as a whole is confronted with controversial processes comprising both domestic and global trends. It makes it reasonable to be very cautious not only about current developments, but also in assessing the possible scenarios and future prospects of regionalisation. On the one hand, the major subjects of regional processes in Central Asia today, i.e. the states, experience a process of formation, attempting to integrate with each other at the same time: the trends which are supposed to complement rather than contradict each other. But, national interests of the states so far could be more intrinsic to a particular stage of development rather than to long-run periods in view of complete domestic socio-

foreign policy. See more in: Pomfret R. *The Economics of Regional Trading Arrangements*, Oxford University Press, 2001, pp.338-340.

⁵¹⁶ The case of Mexico could be an especially vivid example here. After the NAFTA Agreement was signed in 1993, Mexico had to comply with many additional conditions and waivers to the Agreement at the operation level which mainly came as a result of lobby activities in the USA, such as sweet corn lobbies, for example. It engendered many problems for the Mexican government, both economic and political. See more details: Altvater E. *Regionalizatsiya Mirovogo Rynka In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii*. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. Other views, however, proceed from the idea that NAFTA was initiated by the smallest country, i.e. Mexico which then confirmed its commitment to trade and investment reforms. See North American Free Trade Agreement, in Micic M. *International Trade*, St.Martin's Press, New York, pp.494-496.

political and economic reforms.⁵¹⁷ Besides, the national interests are determined by the level of integration into the world community and according to the main provisions of international law; both processes are still underway, too.⁵¹⁸

On the other hand, the future of the scenarios in many respects will depend on the further development of a geopolitical situation in the region and around it, as well as on positions of the countries engaged into these trends. The cases of Afghanistan and Turkmenistan could serve as a vivid example in this regard. Regional processes in general and the regional policy of Uzbekistan in particular seems to benefit these two countries' participation in regional cooperation. For Uzbekistan, security and stability in Afghanistan is undoubtedly top priority in its regional policies. But in the long-run, Afghan involvement in regional processes will determine not the less important issues such as water and energy and transport projects, since Uzbekistan is keen in realizing a number of Trans-Afghan energy and transport projects giving access to Iranian, Indian and Pakistani seaports and markets.

The same is true concerning Turkmenistan. As it was vowed by Uzbek Foreign Ministry's top official, "*existing security threats have a negative impact on prospects of the strengthening of regional cooperation. Besides...terrorism, extremism, drug trafficking, transnational organized crime, one can add the problems with water supply and energy resources, boundary delimitation and demarcations, absence of a common regional transport infrastructure and power systems, environment problems, etc. I can not ignore, that the certain difficulties on a way of regional integration are caused by so called "special position" of Turkmenistan to the given questions*".⁵¹⁹ So far Turkmenistan has ignored almost all main initiatives of regional cooperation. Yet, in the long run if Turkmenistan decides to be a full member of the regional transport and energy projects, it may have a considerable impact on national priorities of Uzbekistan and those of the whole region.

It means that on the one hand, sustainability of the region and attractiveness of regional economic projects in the scenarios are going to increase. But, former interstate cooperation has interconnected security and economic dimensions. Both are definitely necessary. Failure

⁵¹⁷ For example, the difficulties are partly related to a complex definition of real national interests based on the conception of foreign economic policies if reformation of the politics and structure of power in the countries is actively underway. Kyrgyzstan, for instance, returned to a one-chamber parliament in 2000, like in the beginning of independence, after a two-chamber parliament system had been first set up in 1997 and operated only a few years. In Uzbekistan, on the contrary, a new two-chamber system was introduced in 2003 for the first time after 12 years development with a one-chamber parliament.

⁵¹⁸ Talipov F. *Teoriya i Praktika Regionalnoy Integratsii v Tsentralnoy Azii*, Magazine Central Asia and Caucasus, 2002, No 2, p.99.

⁵¹⁹ Speech of First Deputy Minister of Foreign Affairs of Uzbekistan Mr. V. Norov at the Briefing "Uzbekistan's Role in Regional Integration and Ensuring Regional Security", 8 October 2003.

<http://www.eias.org/luncheons/uzbekperspective/norov.pdf>

in one dimension is sure to defeat progress in the other. Developments in the past has revealed that a certain dominance of the former over the latter was observed. If this continues, one may not be easy to depend exclusively upon the benefits of economic viability supported by regional initiatives within each scenarios. They are expected to remain in a significant relationship with national and regional security concerns.

6.4. Contribution of Foreign Partners

6.4.1. Mutually Beneficial Relations With “Good Neighborhood”

Although the Central Asian market is not itself large enough to support a significant degree of intra-regional trade specialization at the current stage of regionalisation, the picture changes substantially when the definition of the region is widened to include Russia, China, Iran, as well as other non-CIS countries. There is a conviction among some groups of non-regional researchers that “it is the liberalization of trade relations in this wider region that should lie at the heart of a strategy of increased integration into the world economy for the countries of Central Asia”.⁵²⁰

Even if the Central Asian states could benefit relatively much from close cooperation with Russia within the third scenario through “better” access to its pipeline and transport infrastructure, it is in the strategic long-run interests of the region to think about the development of other possible alternatives too. In this regard, the agenda of neighboring powers should be also taken into account.⁵²¹

China, for instance, sees much in the crucial and geopolitical significance of Central Asia.⁵²² Therefore, it is interested in enhancing steady economic cooperation with the whole region on bi- and multilateral basis. Among other priorities, China is contemplating Central Asia as a market for its products and investments which have consequently grown comparing to the beginning of the 1990s. In addition, some domestic factors in China have also influenced its goals. Growing needs of the economy for energy products, and political debates to set up national oil reserves have made the region of particular interest in comprehensive Chinese efforts across the globe in search of all possible and diversified energy alternatives for its import. In 2003, China imported 91 mln.tons of crude oil which amounted to almost 40% of

⁵²⁰ Grafe et Al. The Importance of Good Neighbors: Regional Trade in Central Asia, p.117.

⁵²¹ The geopolitical and geoeconomic considerations are more closely analysed in Chapter IV.

⁵²² Bin X. China and Central Asia : A New Dimension of Partnership, in Seidelman R., Giese E. (eds.) Cooperation and Conflict Management in Central Asia, Zentrum fuer Internationale and Umweltforschungspolitik. Justug Liebig Universitaet, Frankfurt-am-Main, Peter Lang Verlag, Band 10, 2004. pp.177-187.

its total oil consumption.⁵²³ Moreover, this figure is expected to rise further. Besides, China and Central Asia are both concerned parties to collaborate in the development of mutually beneficial transport corridors. In 1992 they started to operate a route which is known as the Second Eurasian Continental Bridge, linking the Pacific and Atlantic oceans. Starting in Lianyungang, a port in East China's Jiangsu province, it embraces the Central Asian railways system and ends up in the seaport of Rotterdam in the Netherlands. After a 302 km Tedjen-Serakhs-Meshad (Central Asia-Iran) railway project was completed in 1996, the new length amounted 9,500 km in comparison with the old Trans-Siberian railway route of 14,000 km long. China's railway system was enabled to gain an access to Iranian ports in the Persian Gulf and then, further to the Turkish ones in the Mediterranean.⁵²⁴ But being also of particular importance for Uzbekistan, its operation is complicated by virtue of the political and organizational reasons, as well as by imperfection of available legal base. At the same time, the Uzbekistan-Kyrgyzstan-China rail corridor with 985 km in length is on pre-design stage covering the railroad Andizhan - Osh – Kashgar and expected to be completed in 2009. Economic rationale is fortified by political and security dimensions, on which China and Central Asia are actively collaborating within the Shanghai Forum Organization.

By enhancing regional partnership in infrastructure projects, Iran may also be of a particular interest for Central Asia in bringing its oil and gas to the world markets. A few years ago, for example, Iran initiated an oil swap programme which permits Kazakhstan to ship oil to points on the South Caspian, and then sell oil of Iranian origin from points on the Persian Gulf. Turkmenistan and Iran make similar swap deals for Turkmen gas, too, which allows to transport it from Turkmen gas fields to European (through Turkey) and Asian (India, Pakistan) markets.⁵²⁵

Since insignificant volumes of oil are comprised by current swap deals so far, Iran is ambitiously contemplating the possibility to increase swap oil supplies from the Caspian region through implementation of a number of purposeful projects. In addition, Iran itself is going to benefit by building up additional domestic pipelines for its refinery facilities to meet domestic needs and export to regional neighbors.⁵²⁶

⁵²³ „China sucht Erdölversorgungs-Sicherheit/Aufbau einer strategischen Reserve“, "Neue Zürcher Zeitung", 16 August 2004

⁵²⁴ Azovskiy I. V Poiskah Putey Rasshireniya Tranzitnyh Svyzey, Vostok Magazine. 1997, No 2, pp.108-120.

⁵²⁵ For more details see Chapter IV on energy issue in Central Asia.

⁵²⁶ In particular, such plans foresee a gradual increase of volumes from current 170 barrels to 500 barrels per day by the year 2010. Source: Voropayeva L. Nichego Svoyego. Gazeta SNG, 02 June 2004. See also Chapter IV.

The projects with Iran are the most economically viable and profitable, since it represents the shortest way to its seaports in the Persian Gulf from where one may arrange shipments to any parts of the world. On this occasion, the President of Kazakhstan confirmed the interests of his country by saying that the Iranian route was a better oil export alternative than eastern and western directions.⁵²⁷ The same is true for Uzbekistan whose benefits from sustainable transport projects in the long run will be stipulated by the use of the shortest way to the Southern seaports.⁵²⁸ During the official visit of the President of Uzbekistan to Iran, a Trilateral Agreement between Iran, Afghanistan and Uzbekistan on Transafghan transport corridor and on international transport routes was signed, creating a legal base for a long-existed idea to expand and use the potential of southern direction in foreign relations.⁵²⁹

Thus, taking into account domestic economic potential of such neighbors, as well as particular economic benefits which cooperation with them may bring to the efficiency, and implementation of many regional projects, foreign policies on a friendly footing and the principles of “good neighborhood” are going to be crucial.

6.4.2. Importance of the Coordination Among Foreign Partners

It would certainly be a mistake to assume that Central Asia’s foreign economic strategy has been exclusively fastened on their large neighbour states. In fact, each of the countries has been anxious to secure close ties with the broader international community, including the USA, EU, East and South-East Asian nations. Since this kind of foreign policy in the past decade was driven by the desire to consolidate independence on the one hand and to ensure smooth integration into the world economic system on the other, appropriate international recognition and backing of this path was regarded as an integral part of this process. Given the additional emphasis placed on the region after the events of September 11 and extension of foreign involvement in regional processes, coordinate efforts among multilateral and bilateral assistance programmes will be required. In its turn, there is also a conviction among the governments of the necessity in further increase of such programmes in Central Asia. In

⁵²⁷ Eastern direction suggests an oil pipeline from the Kashagan oil field in Western part of Kazakhstan to Western province of China. The western route implies the participation in Baku-Tbilisi-Ceyhan oil project intending to bring Central Asian oil to the European markets through Caucasus. See more in Chapter IV.

⁵²⁸ If distance is taken into account, the western and southern directions are in clear advantage in Eurasian Transport Corridors: **Northern corridor** Tashkent-Riga – 4008 km; **Northwest corridor** Tashkent-Brest – 4249 km; **Central corridor “Europe-Caucasus-Asia”** Tashkent-Aktau-Poti – 2309 km and Tashkent-Farab-Poti – 2733km; **Southern corridor** – Tashkent-Bandar-Abbas – 3617 km; **Eastern corridors** Tashkent – Lianyungang 4550 km and Tashkent-Nahodka – 8701 km. Source: <http://www.bisnis.doc.gov/bisnis/country/010125trans.htm>

⁵²⁹ Visit of President of Uzbekistan I.Karimov to Iran, www.uza.uz, 17-18 June 2003

particular, delivering a speech at the briefing, the first deputy minister of Foreign Affairs of Uzbekistan emphasized the following: „*We think it is expedient to consider the following issues with corresponding UN institutes, other international economic, financial organizations and donor-countries: substantial increase of aid allocated to the Central Asian states and Afghanistan for development of trade, transport and infrastructure; rendering practical support to the regional and inter-regional projects on transport and communication systems*“.⁵³⁰

Strategically, international assistance could be mainly instrumental in ensuring realization of the two intertwined national and regional priorities of the states mentioned above under the auspices of general sustainable development. The given goal could be achieved through implementation of concrete programmes in different socio-economic areas, such as, for example, improvement of general investment climate; micro-finance and small business development projects; debt and poverty reduction initiatives; capacity-building for government institutions; public investment support and social service improvement.

For these purposes, technical and financial assistance from multilateral donors, such as the World Bank, UNDP, IMF, ADB, EBRD and others may play a great role. For example, since 1997, ADB has launched a special project Central Asian Regional Economic Cooperation embracing the Central Asian states, Azerbaidjan, Mongolia and the Chinese Xinjiang province, as well as nowadays Afghanistan. The project comprises trade, energy and transport as priority areas for cooperation to facilitate growth and prosperity in Central Asia through a gradual elimination of natural and economic constraints (remoteness, seclusion, inefficiency of using natural resources, etc.) and building trust and consensus among countries to set up a ground for dialogue and much-needed coordination.⁵³¹

On a regional level, donors could thus assist in devising a formula for coordination on water resources management; trade and transportation; energy development; rural areas development; health and disease, as well as combating drug trafficking. It is strengthened by the fact that these priorities remain equally strategic areas for development for both regional states and international organizations that may enhance mutually advantageous interaction between the two sides. The World Bank, whose activities have resulted in total \$3 bln.USD assistance since Independence, has opened its regional office in Almaty (Kazakhstan). This

⁵³⁰ Speech of First Deputy Minister of Foreign Affairs of Uzbekistan Mr. V. Norov at the Briefing “Uzbekistan’s Role in Regional Integration and Ensuring Regional Security”, 8 October 2003.

<http://www.eias.org/luncheons/uzbekperspective/norov.pdf>

⁵³¹ Blue A. Central Asia: Development Bank Views Economic Cooperation With Optimism, RFE/RL, www.unece.org/operact/opera/spplled/admin.doc.

institution, like all others, has also pledged to continue its support for national and regional social projects focusing on transport and trade; water and energy; as well as programmes against contagious diseases.⁵³²

The IMF has committed itself to remain fully engaged in providing assistance to Central Asia in its quest for faster sustained growth and rising living standards for all.⁵³³ It was pointed out that the IMF would support the ultimate integration of the region into the world community and therefore, was prepared to keep on rendering necessary technical and financial arrangements for greater regional cooperation as an interim stage promoting to reach the final goals.

Along with multilateral donors, further bilateral assistance is going to be equally beneficial and necessary (Table 6.4).

Table 6.4 Official Development Aid to Central Asia in 2002

	Net ODA (US \$million)	Bilateral (percent)	Major Donors (US \$million)	Population (million)
Kazakhstan	188	90	USA (65), Japan (38), Spain (12)	14.8
Kyrgyz Republic	186	51	AsDF (43), USA (40), IDA (30)	5.0
Tadjikistan	168	68	USA (59), IDA (22), EU (21)	6.3
Turkmenistan	41	86	Arab countries (18), Japan (14), USA (13)	5.5
Uzbekistan	189	89	USA (63), Japan (36), Germany (18)	25.4
Afghanistan	1,285	78	USA (188), EU (95), Germany (86)	28.0

Source: OECD website

The Trade and Investment Framework agreement signed between the Central Asian countries and the USA in 2003 is intended to assist Central Asia through a plan of actions in solving practical issues on investment and trade across the region; lifting trade impediments; improvement in tariff and intellectual property rights policies.⁵³⁴ The Partnership and Cooperation national agreements with the EU and the project of TACIS launched on its basis in 2002 to promote the implementation of the provisions of the given agreement could be another vivid example of tangible interaction which can ensure the region fully to address

⁵³² “World Bank Open Its Office in Central Asia”, Times of Central Asia Newspaper, 02 July 2002. II Ministerial Conference on Central Asian Economic Cooperation, Tashkent, November 2003.

⁵³³ Kohler H. Opportunities and Challenges for Central Asia. Speech at the Conference for the Tenth Anniversary of the Introduction of the Kazakh monetary unit tenge, Almaty, 13 November 2003.

⁵³⁴ «V Vashingtone Podpisano Soglasheniye o Torgovle i Investitsiyah Mejdu Stranami Tsentralnoy Azii i SshA». Kazakhstan Today, 02 June 2004.

current challenges and put its foot down through gradual improvements in domestic socio-economic policies and fostering closer regional cooperation⁵³⁵.

Yet, some limitations should be emphasized in providing efficient international support for Central Asia. On the one hand, all the states have a low absorptive capacity for assistance. Partners and donors have to deal with mainly government agencies or their subordinates with less opportunities to act directly with the private sector. Local governments, as a rule, still lack the skills and budget revenues for self-governance. On the other hand, the development of the private sector is going on slowly due to the controversial process of transition to a market economy. Therefore, business community is sometimes unable to act as a partner for donors, though having a vested interest in attracting additional resources in the short-term to organize and enhance its capacity.

In addition, notwithstanding increased attention to the region after the terrorist acts in the USA in 2001, international assistance and real involvement in the regional trends is still limited.⁵³⁶ This support is unlikely to be sufficient to cover all pressing needs for sustainable development. Multinational donors, such as the World bank and UNDP will not provide huge infusions of cash either. World Bank loans for projects eventually have to be repaid, and regional governments are normally cash-starved, while some of them are even heavily saddled with the debt's burden.⁵³⁷ Besides, the credit allocation process seems to be basically a complex process with particular scrutiny of donors who want to make sure that the resources provided have been effectively used under each programme they have designed which does not always find support among recipients.

⁵³⁵ PCA Support for Implementation project of the TACIS in Uzbekistan comprises a few concrete areas of assistance. They are: economic development support, assistance in transition to a market economy, and an improvement in trade and investment policies, as well as administrative reform, civil society, mass media and NGOs. The work is based on the analyses of domestic legislation in respective fields and development recommendations to bring domestic practices closer to the international standards and those of the EU. The activities are carried out with active engagement of government agencies to promote capacity building and liberalization of economic and political life in the country. Find out more on Information Portal of PCA Secretariat, <http://cfp.pca.uz/>.

⁵³⁶ For example, ADB's total loans in the region from 1997 to 2001 amounted to some \$1,2 bln.USD which was only 3,7% of ADB's total loans, and this process of funding is likely to remain constant further on. Blue A. Central Asia : Development Bank Views Economic Cooperation With Optimism, RFE/RL, www.unece.org/operact/opera/sppled/admin.doc.

⁵³⁷ The IMF CIS 7 initiatives comprises Armenia, Azerbaijan, Georgia, Kyrgyzstan, Moldova, Tadjikistan, Uzbekistan to address debt problems which the countries of the CIS are facing with. Tadjikistan and Kyrgyzstan were affected especially badly at the end of 2001 with external debt/GDP ratio 107,6 and 118,5%, respectively, which was higher the average in other CIS (62,3) and transition countries (43,7%). Since in 2002 debt burden increased for Kyrgyzstan and Uzbekistan, the former was seeking the ways of partial restructuring of total debt amount in the recent past, while the latter remained assiduous with all payments of its external financial obligations. Helbling T., Mody A., Sahay R. "Debt Accumulation in the CIS countries: Bad Luck, Bad Policies, or Bad Advice" IMF Working Paper 04/93, <http://www.imf.org/external/pubs/ft/wp/2004/wp0493.pdf>. See also "A New Initiative for the CIS 7". 02 February 2002. <http://www.imf.org/External/NP/EU2/2002/edebt/eng/040202b.pdf>.

Consequently, even if substantial assistance is crucial, its amounts and effects may be moderate, until common structural changes within the states themselves through gradual, incremental and result-oriented steps between the regional countries to facilitate regional process will take place. The business community determines the degree of their involvement in joint projects within the context of integration processes taking place in Central Asia.⁵³⁸ Only in this case, one may pin one's hope for intensification of international assistance to the region over the long-term.

6.4.3. Methods to Promote Regional Cooperation

Multilateral and bi-lateral activities in Central Asia would be then even more efficient if donors would not only coordinate their efforts in general and particular projects, but would exchange and share common views on persistent methods and approaches applicable to local conditions of regionalization, too. Donors will probably have to continue to put forward initiatives promoting a mutual dialogue within and among the countries of the region which may be produced by the assistance to address critical issues related to national reforms and sub-regional cooperation; higher popular participation in economic and political decision-making; and by exploring new approaches to development, such as tapping more into local resources for increasing economic activity.⁵³⁹

Since for the most part of past development, international assistance was dominated by aid projects with primarily the government sector, diversification of this approach will require creation of conditions in which the private sector could also benefit from such initiatives in the region. The projects of direct economic impact, such as small and medium-sized business and micro-finance or credit unions development, for example, could be a starting point, since their benefits are palpable and could bear both, national and regional positive effects for the societies striving for the establishment and enhancement of a strong and sound private sector.

It is of particular significance that such suggested purposeful confidence-building measures would encourage the states to bring actors outside the central governments into the economic process which may facilitate horizontal linkages across the region between different levels of the society. It is an important factor which may have a very strong and positive social regional impact arisen from the initiatives embracing NGOs, associations, unions, etc. and their

⁵³⁸ Alimov R. and others (eds). *Tsentrlnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost*. Tashkent, 2002, p.67.

⁵³⁹ Hill F. *Areas for Future Cooperation or Conflict in Central Asia and Caucasus*, Yale University Conference "The Silk Road in the 21 Century", 19 September, 2002. www.brook.edu/views/speeches/hillf/20020919.htm.

potential contribution to regional trends. This contribution may come from regional meetings, conferences, workshops, round tables and other possible events on different topic organized by such non-governmental set-ups in which private entrepreneurs, businessmen, scientists, politicians, mass media and many others have good opportunities to meet directly to exchange views on top challenges of regionalism and cooperation; and subsequently develop recommendations on how to address them in a most appropriate way. They can also assist in the establishment of direct and sustainable links between administrative and economic territories, especially in border areas where presumably a significant suppressed signal for such cooperation could come from. Through the support of regional associations and unions, international assistance is expected to reinforce regional structure activities for the creation and sustainability of regional markets for goods and services; as well as to broader and direct contacts between territories, regions and cities in Central Asia.

In the financial area, for example, assistance could be essential in the development of the banking and non-banking sector. The establishment and support for credit unions, insurance and investment companies, for example, is currently at its embryonic stage and thus needs further financial and technical arrangements to open itself to a larger extent. If they develop properly, their activities may contribute substantially to the expansion of the private sector by providing much-needed services in the elaboration of business plans, investment projects, as well as bolstering up trade initiatives, all of which are supposed to be equally significant development goals for all the states.

However, foreign involvement in fostering regional projects must not be considered in the narrow frame of confidence-building measures only. Its impact could be much broader if high-level dialogue will assist the governments to improve and coordinate their national policies on common use of natural resources, environmental protection and water management. The latter is especially essential given repeated droughts, the catastrophic depletion of the Aral sea, widespread pollution and degradation of water resources in addition to their immediate economic and social effects for each country. Therefore, in the nearest future, it is more likely that pragmatic support might focus on bi- and multilateral cooperation among selected Central Asian countries, and on country-specific reform and investments for improved water management in the region.

Broader engagement of bi- and multilateral donors in the post-conflict reconstruction and development of Afghanistan with the direct participation of the other countries of Central Asia in this process is also expected to make up a solid basis for closer interaction on a wide

range of common issues between donors and Central Asia. Stability in Afghanistan and reintegration of the given state into the world community is going to exert a positive influence upon many regional processes in the long-run. The role of Central Asia in renovation processes in Afghanistan should not be underplayed. On the contrary, the states of the region are able to join their resources and experience to render an effective and viable strategy not only to bring Afghanistan back in the world community, but also to assist it in becoming again a part of the secular, multinational and culturally diversified Central Asian region.⁵⁴⁰

*“Uzbekistan thinks that the reconstruction of life support systems as well as rehabilitation of Afghan economy are the necessary and basic conditions for settling peace and socio-political stability in the country and, as a consequence, for strengthening regional and international security. Furthermore, from the earliest times, Afghanistan was one of the important transit networks and, hence, its transport and communication capabilities provide great perspectives for the regional and international cooperation”.*⁵⁴¹

From this viewpoint, Uzbekistan has currently renewed supplies of about 2,5 mln.kWh of electricity annually to the northern parts of Afghanistan, mainly free of charge. Uzbekistan has expressed its willingness to take part in reconstruction and upgrading of various objects of hydropower infrastructure, the irrigation system, the oil and gas sector, as well as to supply goods of domestic textile, construction and chemical industries for the neighbor country. Particularly, Uzbekistan participates in reconstruction and rebuilding of 10 bridges on Termez - Mazari-Sharif –Kabul route, 5 of which have already been put into operation. The government of Uzbekistan has expressed its preparedness to build the Khayraton-Mazari-Sharif railroad and the Khayraton-Puli Khumri power line, to take part in the tender on building of an electric power station, to reconstruct waterworks facilities in Jalalabad, Sarda, Kokcha and to construct power facilities in the Northern and Central regions of Afghanistan.⁵⁴²

⁵⁴⁰ Alimov R., Antonenko O. Rol Progressa po Vosstanovleniyu Stabilizatsii Afganistana v Ukreplenii Stabilnosti i Bezopasnosti v Tsentralnoy Azii. Materials of the Conference “Stability in Central Asia in Post-Conflict Period”, Tashkent, 2002, p.7.

⁵⁴¹ Speech of the First Deputy Minister of Foreign Affairs of Uzbekistan Mr. V. Norov at the Briefing “Uzbekistan’s Role in Regional Integration and Ensuring Regional Security”, 8 October 2003. <http://www.eias.org/luncheons/uzbekperspective/norov.pdf>

⁵⁴² In December 2003, a preliminary feasibility study of the first railway Khairaton-Mazari-Sharif, with a budget of more than \$100 million has been prepared jointly with American companies. The U.S. government is considering the possibility of funding this project. See «International transport has top priority for doubly landlocked country». Interview with Rustam R. Yunusov, Deputy Prime Minister of Uzbekistan, <http://www.internationalreports.net/asiapacific/uzbekistan/2004/deputy.htm>

In addition, the current role of Uzbekistan is to serve as a transit territory for international and regional humanitarian aid.⁵⁴³ Since the beginning of reconstruction work, two million tons of cargo were transported through Uzbekistan to Afghanistan.

In June 2003, the Agreement between Uzbekistan and Afghanistan was signed on the corridor to connect Central Asia with Iran through Afghanistan, while an extra project enables to reach the Pakistani ports, too.⁵⁴⁴ If they are realized, these Trans-Afghan corridors may be mutually beneficial, since it may also assist the rehabilitation of the Afghan economy through improvement of the infrastructure, creation of jobs, and transit fees from intensified cargo traffic in both directions, to and from Central Asia. Generally speaking, in doing so, the region may do even better in addressing its own regional infrastructure bottlenecks, but also promote the efficient solution of the issues of international significance.

Thus, in order to realize cooperation initiatives in the region, in addition to the enhanced self-endeavors of each country here it will be necessary for international society (donors) as well: (a) to continue to expand trade relations with the regional states; (b) to continue with the provision of official development assistance; (c) to promote private direct investment inflows; (d) to assist in fostering various technical programs for local officials, to help them administer their economic management. Equally however, international community will have to show the relatively young states of the region a certain degree of indulgence and tolerance for the speed of domestic reforms, addressing various problems of their transition to a market economy and achieving their sustainable development. Surely it will take time for them to acquire new techniques and skills of acting in newly globalised terms.

6.5. Summary

The newly independent states of Central Asia had to implement strategies for economic development since becoming independent of the Soviet Union in 1991. Simultaneously, in keeping with the general resurgence of regionalism in the modern international order there has been a proliferation of regional and subregional groupings involving four Central Asian states Kazakhstan, Kyrgyzstan, Tadjikistan, and Uzbekistan. However, whereas the limited opportunities to comprise all these set-ups within the given work, an emphasis was put on the scrutiny of the progress made, as well as future perspectives within the Central Asian Cooperation Organization only, as a pivotal structure of regional efforts touching upon

⁵⁴³ Safaev S. *Regionalnoe Razvitie i Postkonfliktnoe Vosstanovlenie Afghanistana*. Materials of the Conference “Stability in Central Asia in Post-Conflict Period”, Tashkent, 2002, p.30.

⁵⁴⁴ Termez-Herat-Kandagar-Kveta-Karachi and Termez-Mazari Sharif-Kabul-Kandagar-Chaman-Kveta-Karachi routes are discussed as possible road projects in the interests of Uzbekistan. Alimov R. and others (eds). *Tsentrlnaya Aziya: Geoekonomika, Geopolitika, Bezopasnost*. Tashkent, 2002, p.26-41.

exclusively the countries of Central Asia, set aside Turkmenistan which has currently ignored membership in any of the dozens of regional initiatives, but whose participation in the regional projects remains perhaps a matter of time.

Regionalisation, understood as an active process of changes toward increased cooperation, convergence, coherence and identity, was not an obvious feature of policy interactions in Central Asia in the past decade. At the same time, a number of common elements, such as historical and ethnic preconditions, confessional community, geographical proximity, and largely similar socio-economic challenges, gave birth to the perceived exigency of regional cooperation even before Independence. The idea suggested by the President of Uzbekistan in the early 1990s was named “Turkestan is our common home” was reflect an attempt to combine the region’s past with well-developed ideological conception in order to reinforce common regional identity. Bringing forward the need for cooperation, the idea was expected to unite all forces concerned in this process, and make every citizen aware of the aims and tasks of such efforts.

Yet, many of the newly regional states have discovered that cooperation with their neighbors, even those having similar interests and goals, was not always easily attainable. As a result, many regional efforts today have proved to be more declarative rather than reflecting any significant step forward toward the goals designed. Neither any customs area, nor free trade area, nor any single economic space ensuring free movement of goods and services and factors of production have been created. It affected the intra-regional trade which dropped from more than 15% to 7% as share to total trade turnover of the whole region. Common market, thus, has been now considered to be a more distant goal towards which the countries have agreed to move gradually as necessary conditions for further steps are in place. The main reasons of such a faint pattern were not only objective difficulties of transition to a market economy expressed in substantial drop in regional countries’ GDP and output (20-60%); inadequate institutional base to pursue financial, tariff, trade, tax and other policies in new conditions; external shocks, such as negative trends in world markets, Russian financial crisis, etc. Most probably, enhancement of national priorities, and subsequent differences in strategic realization of these tasks, nation-building and political liberalization were the forces inversely proportional to centrifugal regional processes. Facing current economic and socio-political problems of global and regional trends, the states have probably recognized that it was easier for them to protect independence and the interests of their own in the short run rather than to join forces for common regional policies and reap the benefits in the longer perspective. In other words, national priorities have not always dovetailed with regional ones, while the states

were loath to make concessions in the regional decision-making which might pose a threat to their relatively young sovereignty.⁵⁴⁵

Under such circumstances, nevertheless, the experience of the states with still brief independent development confronting with socio-political and economic challenges appears to be short to draw final conclusions in forecasting the true potential for regionalism in Central Asia in the even foreseeable future. The suggested models for prospects of regional developments are very general with a number of assumptions and constraints: political and economic stability, structural and institutional reforms, role of foreign investments and donors, further liberalization of social and political life. The first scenario is based on the assumption that the economies of the region are insufficiently complementary which gives no strong economic incentives for the expansion of regional trade and economic linkages. The countries may continue regional cooperation primarily on the bilateral basis which is going to be sufficient to address regional problems. On the contrary, countries will keep on independent economic integration into the multilateral economic community through the strategy of export globalism by virtue of abundant resource base. While small economies of Kyrgyzstan, Tadjikistan, and Turkmenistan in perspective will remain minor players in the global economy, both of the larger countries - Uzbekistan and Kazakhstan could become significant middle-size economies, but rather in their own right rather than as part of Central Asia. In terms of further divergent economic characteristics, it is reasonable to expect that it will become an even more elusive idea to implement regional integration in the future. The region may remain a big exporter of raw materials and commodities, but substantially dependent on imports of capital and consumer products further in the future.

The second scenario takes into account the postulates of the functionalist theory which allows the countries of Central Asia to depend upon better regional perspectives to the extent, to which progress in particular areas of cooperation (energy, transport, trade) has been made. It may result not only in better economic outcome from joint activities, but more importantly, in the establishment of solid long-term benefits on the basis of confidence-building measures on different levels of regional economic relations. Concerted efforts to upgrade the regional energy system to meet regional needs and make sustainable export; construction of intra- and interregional pipelines and transport corridors to reach the world markets at the least costs; and common tariff and custom policies which may eventually result in deprivation of tariffs, unification of trade regimes, and dismantling other trade barriers, will unconditionally serve

⁵⁴⁵ Komissina I. Uzbekistan i Politika Regionalnoy Integratsii v Tsentralnoy Azii, in « Uzbekistan : Obretniye Novogo Oblika », Volume II, Russian Institute for Strategic Studies, Moscow, 1998, p.221.

to foster close regional interaction. The regional market of Central Asia may experience slow, but sustainable progress. There is also a political rationale implying reinvigoration and reinforcement of confidence-building measures in economic projects, with their positive impact on political and security dimensions. In this regard, the role of Uzbekistan could be of particular significance to promote this success due to its linking position between the regional states as well as its desperate interests in having access to the world markets which in turn is substantially pre-determined by the success of regional initiatives. The main constraint is that this scenario is hardly realizable by the efforts of the Central Asian states only. Both, financial support and reasonable technical mediation from the outside may be required.

The last scenario takes into account the developments arisen from successful economic and security cooperation with Russia which has been recently invited to become an equal member of the CACO. Dependency upon traditional economic linkages with the northern neighbor makes Central Asia and Russia economically more interdependent and complementary which allows the regional countries to hope for tangible economic benefits from Russian investments into regional economies and assistance in the upgrading and expansion of the existing infrastructure facilities. The question is open to debate whether short-run benefits are going to serve regional interests in the long-run, too. For this, a balanced and multifaceted analysis is necessary in order to define potential economic and political benefits and the costs of these developments in the future.

Finally, international experience suggests that regionalism among developing countries is not similar to that in the developed parts of the world. Hence, it should not be expected to flourish quickly on the basis of the political blueprints of regional governments or even external contributors. Concrete challenges have still to be addressed and overcome to reach the more mature expression in even comparatively more advanced regionalism in Asia Pacific or ASEAN, for instance. With respect to Central Asia, the following words could be quite pertinent to define a specific role of time to challenge the current reality and hope for better regional perspectives: “In some restaurants, you will find a small note in the menu recommending you to be ready for waiting if a delicious meal is wanted, since good food requires some time to be cooked. In other words, in terms of Central Asia, time is necessary to develop and carry out reforms. Equally time is essential to learn working together. Regional integration is not going to be so merely attainable”.⁵⁴⁶

⁵⁴⁶ Akiner Sh. *Mejregionalnaya Strategiya Ekonomicheskogo Razvitiya i Integratsii*. Materials of the Conference “Stability in Central Asia in Post-Conflict Period”, Tashkent, 2002, p.64.

VII. Conclusion

For several decades, Uzbekistan has been largely secluded from the trends in the external world. All foreign relations were handled through Moscow. Consequently, with the exception of a handful of senior officials from the local elite, very few individuals representing the republic had any firsthand knowledge of and access to life beyond the Soviet borders. That is why, when the Soviet Union collapsed in 1991 due to long-lasting and acute challenges in domestic political and economic life, the governments of all Central Asian republics, including Uzbekistan, became actively involved on a much wider scope in a new field of foreign affairs that was relatively new to them.

Foreign policy planners in Uzbekistan were confronted with several simultaneous tasks: finding the niche in the international arena; defining their national interests; identifying friends and partners; and prioritizing objectives. However, the realization of these tasks has had an exploratory character and policies have been tentative not only due to a significant lack of experience, but also because of a number of domestic economic challenges. Generally speaking, Uzbekistan declared to build up a socially-oriented market economy with parallel domestic reforms related to the creation of a new political system based on purely democratic principles. However, the republic had to face some serious macroeconomic problems, especially in the first years after the collapse of the USSR. These problems were mainly reflected by macroeconomic destabilization. The fall of the GDP (19% in 1991-1995) and the decline of industrial production were observed, although the GDP decline was smaller than the average decline in the CIS countries (30-70%); inflation reached its highest annual level ever culminating in four-digit figures (almost 1600% in 1994).⁵⁴⁷ The situation was caused by a sudden collapse of economic ties with the other republics, interrupted supplies of goods and services within the already non-existing Soviet division of labor and poor efforts to keep up common economic space in the framework of the CIS initiatives. It might be also connected to the inability of domestic economic units to behave in new conditions of sweeping market relations, lack of funds and galloping inflation, losses of investment resources, as well as by steady deterioration of the local industrial base. In addition, the general socio-economic situation remained complex. According to some data, almost half of the local population had already lived below the poverty line, even prior to the collapse of the Soviet system. The specific demographic situation with one of the highest population growth rates in the entire USSR was continually getting worse after independence in terms of shrinking domestic

⁵⁴⁷ According to EBRD. See: Transition Report 2002.

production.⁵⁴⁸ The fact that almost 60% of its population was under age 25 exerted a pressure on the social situation. Besides, this was exacerbated by an ideological vacuum emerging after the collapse of the old Soviet communist dogma. This vacuum, which was particularly strong in conservative and highly populated rural areas where most of the poverty risk groups used to be concentrated, was being immediately filled with several ideas of a radical character. These ideas initially appeared in the 1980s and were disseminated especially widely on the eve of independence. In the predominantly Islamic society of Uzbekistan with a strong traditional and conservative outlook, these ideas were seen as a real threat to a government striving for a more secular way of life.

In this regard, domestic stability and the avoidance of potential social conflicts qualified as an important criterion in defining pace and the essence of domestic reforms. A bang-bang strategy with drastic price liberalization, massive privatization of state enterprises, and the liberalization of the foreign economic sector was thus defied. The government allowed some old institutions to adjust to new conditions as well as enforced new market set-ups which did not exist in the republic in the Soviet era. The following “five” principles announced by President I. Karimov, i.e. de-ideologization of economic processes; the superiority of law; government as the main reformer; social security policy; and gradualism in pursuing the reforms, gave birth to the so-called “Uzbek model of economic reforms”, favoring national policy over other possible choices.

Although the economic performance of the republic was marked as rather moderate in comparison with sweeping reformers from Central and Eastern Europe, it is still open to debate, whether policy recommendations according to the principle one-size-fits-all might have brought equal results in Uzbekistan or anywhere else in the region. For instance, the given principle seems to be only loosely connected to the fact that Kyrgyzstan, which had most faithfully followed the advice for reform, did not perform better in terms of economic growth in the past decade than Uzbekistan⁵⁴⁹, though there might have been other factors involved, such as endowment with natural resources, skilled bureaucrats, socio-cultural factors, etc.

Uzbekistan will thus need to find the mechanism which could be capable not only to deal with the issues of purely economic character, but is also looking at the issues in the context of

⁵⁴⁸ Total fertility rate was between four and six birth per woman in Uzbekistan, Tadjikistan and Kyrgyzstan in the early 1980s, reflecting the highest growth indicators in the entire CIS. Although Uzbekistan has been experiencing almost 50% decline in population growth after the Independence, its population has increased by about 56% for the last two decades. See: Mueller K. Poverty and Social Policy in the Central Asian Transition Countries, GDI, Bonn, April 2003, p.25.

⁵⁴⁹ Tanaka T. Stability in Central Asia in the 21 Century: an Economic Approach, in “Central Asia in 21 Century: Cooperation, Partnership and Dialogue. Materials of the International conference. Tashkent, 2004, p.135.

broader, political transformation and its perspectives in XXI century. Nowadays, we may speak about three main aspects of development which require a close scrutiny through the prism of local conditions in Uzbekistan. These areas may be represented in the form of a triangle with national and regional policy objectives at the two lowest corners and global goals at the top. Each of the models suggests both specific benefits and losses within a definite demographic, technological, financial, foreign economic, and ecological framework which may vary correspondingly in space and time.

As history shows, despite the declared objectives in the early 1990s to link national, regional and global goals, the main emphasis in Uzbekistan had been placed on a national development model which implied uncontested sovereignty over all policy issues and a decision-making process. Partly as a result of this approach, the policy prioritized import-substitution industrial development by making the use of domestic potential through strong government intervention and resource redistribution. In line with the envisaged priorities, this model's achievements, however, are limited due to the difficulties associated with its implementation. This mainly bears high risks of resource misallocation among different sectors compared to more liberalized market relations; high costs to realize the strategy which may require foreign injections increasing country's long-term external debt problems; high dependency of national policies on external factors, such as world prices, economic and political situation in the main trading partners, the state of regional infrastructure, etc.; low efficiency of domestic sectors due to the absence of competitive pressure and incentives towards more effective production which may subsequently lead to monopolisation and higher prices in domestic markets; limited absorptive capacity of domestic market which reduces the scope for benefits from economies of scale in some large-scale production (auto industry, aviation industry, etc.); comparatively insignificant volumes of FDI; proliferation of lobby interests whose narrow interests may favor particular groups, ministries or producers rather than society in general which is suboptimum for common public welfare.

Hence, where national policy lacks the tools to achieve its goals, a regional model might be quite helpful. For instance, it suggests more chances to benefit from economies of scale; self-sufficiency in a number of products whose import is complicated due to lack of foreign exchange, high transport and shipment costs, etc.; lower transaction costs for private sector development in terms of free mobility of capital, labor, goods and services; enhancement of competition facilitating domestic structural changes, better performance and employment in real sector; higher efficacy of actions against the potential negative consequences of globalisation processes due to more coordinated policies with other similar neighbor

countries; assistance in finding more viable solutions to both national and regional problems (political, economic, security, ecological, social, etc.). In sum, the country may face opportunities for more sustainable development, long-term growth and social welfare. At the same time, the main challenge in implementation of an effective regional model, as international history shows, lies in reaching inter-state agreements over the distribution of costs and benefits of regional initiatives among member-countries. Since it can be expected that the scope of costs and benefits will not be equal for all parties concerned, it might require strong political decisions from the governments to give regional projects a desperate push. In other words, in terms of Central Asia, the fate of regional cooperation will seemingly depend on economically stronger states, such as Kazakhstan and Uzbekistan, both with respect to their bilateral relations and the relations towards other states in the region, Kyrgyzstan and Tadjikistan.

Within a global development model, Uzbekistan, like all the other Central Asian states, sees globalisation as an inevitable process. The country has joined many key international organizations, while negotiations for membership in the others, such the WTO in which Uzbekistan was granted observer status, has already been kickstarted, too. By taking a more active part in the global environment, the country is believed to safeguard its legal position in fair global trade, reducing barriers to its main exports, benefiting from transborder investment flows, innovations, know-how and equipment as well as from development assistance. Simultaneously, however, it still needs to be defined what the real impact of globalisation on the domestic situation could be in terms of gains received and costs which might arise in accordance with international obligations to liberalise domestic conditions (current account problems, budget deficit, employment, etc.). Uzbekistan is a small country, which implies its limited influence in global terms, while its own vulnerability to global processes remains high. For instance, although the importance of FDI for the country's development is widely acknowledged, no definitive conclusions could be made with respect to its monotonic positive impact on the domestic situation to resolve national issues, such as needs for new technologies, export promotion or strengthening competition. As expected, it may particularly exert competitive pressure on local firms urging them to move towards more efficiency; but it may equally deteriorate competitive environment via monopolisation of local markets, especially small ones, by persuading the government of a recipient country to follow protectionist policies against imports, seeking for less competition from other foreign firms. In other words, investment come to make profits, while the government's national policy tools

prove to be limited in global terms with its long-term development goals being of less direct significance to investors.

Are the aforementioned models complementary, or do they conflict with each other in terms of implementation? No clear answer to this question is available so far. There might be two alternatives in implementing these models: 1) by following a step-by-step strategy; 2) simultaneous moves in different areas. The first variant is more easily realizable in view of prioritising specific goals and the areas of actions with the subsequent concentration on implementation of the measures envisaged. However, it is apparently a more time-consuming process in which some interests may be favored at the cost of the others. In addition, it does not look that any of them at its own will be able to resolve existing problems. All the countries of the region favored national policies in the past, making efforts to consolidate acquired independence and strengthen their positions globally through diversification of foreign partners with less attention being paid to regional issues for various political and economic reasons. Nevertheless, although with many things having been already done, the reforms in the regional states are still far from finished which very often due to the fact that the efficacy of national projects may go far beyond just national borders. In this regard, the second way which regards coordinated steps in each area as an important element, is more desirable, since it attempts to tackle the issues in a three-edge way by taking a broader view at the role of each area. For example, currently Uzbekistan's industries are almost noncompetitive in global terms, but they could be demanded in the regional markets of the CIS and Central Asia. In the latter case, it is economically more viable to position in regional markets due to lower shipment costs. Moreover, there are some areas in which the region still faces insufficiencies, but which could be eliminated if proper policy actions at the regional level were made. This would not only promote the solution of regional problems, such as energy and food deficiencies, transport infrastructure, security dimensions, and so forth, but also improve the region's position globally because of higher investment flows and fair trade as well as nationally through facilitating domestic reforms. Global markets remain nevertheless critical for the country in terms of needed technology and investment to modernize domestic industries. The main difficulty with this approach is that it is easier to design, but problematic to realize. In practice, this looks like a complex task due to the lack of effective policy tools, so far unfinished reforms, potential lobby resistance, and therefore, its implementation becomes dependent on a strong political will to carry through any projects.

Thus, what would policy actions specifically mean for Uzbekistan in the years to come in the context of such a multi-pronged approach if it were favored? As mentioned earlier, the issues

are expected to be national, regional and global in nature. A national element of the strategy may embrace several key reform areas, including agriculture, the energy sector, small- and medium-sized businesses as well as structural and institutional measures.

Agriculture remains a priority target of the reforms in Uzbekistan in the years to come, since it makes the largest contribution to the GDP and still involves more than half of the total domestic labor force. It is necessary to continue with the measures which will allow the increase of efficiency in the sector and also lead to a higher income, as for example: appropriate property rights protection; enhancement of market relations by minimizing the ground for bad practices of inefficient distribution of production factors for farmers (land, material and technical and financial resources), as well as bureaucracy and protraction in decision-making on pressing agricultural issues; improvement of social and production facilities in rural areas, including a better water management and its use in agriculture; encourage and assist in benefiting from new technologies in the production process; regular training and upbringing of specialists and entrepreneurs on all regional and national levels, involved directly in production or decision-making processes.

The main goal of market reforms in agriculture is to set up an environment in which a producer would be a core figure fully responsible for the decisions on output, its volume and prices. The question concerns a complexity of measures which could increase and help maintain financial sustainability of agrarians. In other words, it is important that agricultural policy should centre on higher efficiency in the sector through an adequate management of price mechanisms which in turn would secure both better returns from investments into the sector and sustainable agricultural production, too.

Sustainable economic growth is also related to the encouragement of small- and medium-sized business whose success is in turn highly dependent on the improvements in the domestic climate. The rule of law is critical to ensure legal protection of the private sector, the rights and interests of entrepreneurs. The work should be continued to provide wider access of SMB to local and foreign financial, consultative and other technical support which would strengthen their position on domestic as well as on foreign markets. The expansion of activities through direct cooperation links with foreign partners and better access to the markets beyond national borders would intensify the flexibility of SMB and increase its contribution to the strengthening of competition, creation of jobs, inflow of foreign capital, all of which are critical for economic growth.

The reforms in the energy sector seem to occupy another important place among necessary steps to secure a stable economic development. So far, these reforms have been induced mainly by a relatively low efficiency in the sector affecting competitiveness of the whole economy in the global arena. Energy intensity of the GDP in Uzbekistan remains 3-4 times higher than in the developed part of the world and 1,5-2 times higher than in South-East Asia and Central Europe, which results from the inefficient use of resources in the domestic economy. Hence, the following tasks acquire primary meaning in the forthcoming future: to maintain the modernization and innovation process; to improve the organization structure and the decision-making process by a gradual demonopolization and decentralization; to take steps towards the coordination of efforts with other regional countries dealing with the development, modernization and expansion of production and transportation facilities, in order to create a common regional energy market in Central Asia.

In dealing with foreign investments, several significant measures have been already taken, especially since Uzbekistan became a signatory to the Article VIII of the IMF Agreements on Liberalization of Current Account Transactions in the fall of 2003. Yet, further work should be done to improve national legislation as well as fiscal and custom policies. Specifically, some legal steps should be taken to expand opportunities for the use of a rich mineral base, encouraging foreign capital to take part in geological and exploration activities as well as in the privatization of large-scale industrial enterprises which are involved in the given field. Besides, the textile and food and tourism industries still contain high investment potential which could be strengthened through adequate fiscal and customs policies. In this regard, the role of information is not to be underestimated. This requires an effective information strategy realized through a network of government and non-government institutions. The experience of successful Asian economies (Japan, Malaysia, Chinese Taipei, Korea) was that they succeeded in attracting substantial amounts of foreign capital due to a mixture of active trade and information support. Thus, these policy measures may include: better involvement in international expositions and fairs; organization of conferences, workshops, round tables on the mutual and multilateral level; the cooperation with credible consulting and financial groups in the preparation and edition of investment guides and business publications; the expansion of activities through a network of diplomatic and trade representations of the country abroad; and the continuing training of local experts in the foreign economic field.

As far as regional actions are concerned, the Central Asian direction becomes critical for Uzbekistan. In the early 1990s, it was mainly economic imperatives to preserve common economic space in order to alleviate or at least beset the consequences of the collapse of the

USSR. Later, these imperatives have been much diversified and subsequently included socio-political, demographic and cultural dimensions as well. Independence has brought not only freedom to express one's own ideas, develop the principles of domestic and foreign policies, and the right to determine the future of people's living in the country. With independence, as mentioned above, the whole region had to face inter-state border, territorial and social conflicts, under the pressure of poverty and unemployment, as well as national security threats in face of international extremism, religious fundamentalism and drug traffic.

Although former regional efforts have been mainly marked by security concerns, nevertheless the economic aspect remains on the agenda, since its potential is still unrealized. Some researchers believe that Central Asian countries lack economic pre-requisites for fruitful cooperation in view of similar export structure, shortage of investment resources, low concerns in intra-regional trade, existing distortions in the contemporary market relations, as well as some variance in the level of economic development. Given these arguments, the process of close multilateral regional cooperation could start with a few core areas of mutual interest which include trade, energy and transport.

All the countries are land-locked, while Uzbekistan is double land-locked. It means that all the countries have clear difficulties to reach world markets for their imports as well as their exports. In Uzbekistan, for instance, import and export operations play an important role with each of them making up slightly less than one third of its total GDP. Central Asia is able to be self-sufficient in merchandise products, especially in food and minerals. With the appropriate mixture of trade, customs, tax, fiscal, legal policies, there might be much more focus on intra-regional trade, while costs of shipment from other regions would also be diminished.

The growth of the export from the region is substantially dependent on the transport corridors and infrastructure facilities to be built and commonly used by the regional states. Among a number of routes, the southern one is the shortest and therefore important to all the states, since it may give final access to the Indian Ocean through Afghanistan and Pakistan and to the Iranian ports in the Persian Gulf. However, the main routes in the given direction are still to be constructed given the socio-political stabilization in neighboring Afghanistan. In addition, Central Asia may benefit from inter-regional cargo traffic, since Russia, China, Iran, India also wish to expand trade activities with other regions. But for the region itself it is crucial that the reliance on transit economic development alone is not providing sustainability in growth. It means that the regional states should first and foremost develop their own trade potential and then strengthen intra-regional trade, too.

In the energy field, cooperation on the regional level acquires a particular significance with two strategic goals on the agenda: self-sufficiency of the region in energy resources; and development and diversification of a pipeline network system inside and outside the region. Central Asia in general has a vast energy base which, however, is unevenly distributed throughout the region. The regionalisation of Central Asia's energy markets has a bright future, if pursued properly, because the regional states are closely connected through an existing regional energy network and through trade of energy resources. Besides, there is still a shortage of energy in some countries. Therefore, cooperation between Central Asian countries in the sphere of energy will imply establishment of the regional energy market, coordination in pursuing intra-regional and interregional energy policy, in order to maintain intra-regional energy security and efficiency of regional energy exports. It would be unwise and wasteful to restrict trade in energy resources to Central Asia simply because it has already a power production potential and the vast resources exceed the existing regional needs.

The main obstacle preventing a further increase in exports of fuel and energy from the region is the insufficient and non-diversified network of pipelines that bring oil, gas and electric power from Central Asia to world and regional energy markets. A number of energy projects with foreign assistance are at different stages of development. Thus, foreign investment in the Central Asian energy industries can only be further welcomed. Yet, the future of regional projects seems to be exacerbated by the necessity to balance geopolitical and national interests of the USA, Russia, EC, Iran, China, Pakistan, Turkey. If rivalry between the main players continues, it may be of little use for Central Asia's efforts to solve its desperate energy infrastructure problems, to efficiently use resources and to secure sustainable foreign exchange and investments into the regional economies. On the contrary, if the main potential competitors work together to share a common strategy regarding the costs and technologies, which are desperately needed in Central Asia, it may create some pre-conditions for the prosperous and sustainable development of the region.

Hence, if regional projects are to make good headway on a large-scale and long term basis, they will require the backing of bi- and multilateral donors which highlights the importance of global policy actions. Based on a systematic, coordinated, and persistent approach, donors might continue to assist in the realization of concrete projects in energy, water management, trade and infrastructure development; they should facilitate engagement in dialogue on national and regional reform strategies; foster technical assistance in the expansion of horizontal linkages between the private sector, local authorities and administrative and territorial units which all together may result in better coordination and cooperation across the

region. Major powers should be no longer regarded as competitors, but they should be considered equal. The USA and Russia could represent a vivid example in this respect: Russia may be interested in a stable and dynamically developing Central Asia, whereas the USA may be concerned in domestic stability in Russia itself which in turn is going to be significantly dependent on secure southern borders. Definitely, the EU, China, Japan, Iran may also share an interest in a new order of bi- and multilateral relations both with Central Asia and with each other. This approach would perfectly fit the declarations of local governments, although it is difficult to predict which of the parties concerned could make the first step.⁵⁵⁰

Once again, regional policies should not be perceived as a single area only, but need to be seen in both the national and global context. Speaking broadly, it may provide a solid ground for the realization of long-term national priorities, such as a sustainable market economy and an open democratic society. In addition, it may give another good opportunity to cope more consequently and effectively with the constraints of the region, such as remoteness and insulation from mutual collaboration with the world community with which the region has been confronted for decades of former historical development. In general, the policies on the national, regional and global levels are intertwined with each other, but not sufficiently integrated to suggest a universal recipe for development. It reminds us of the sides of a triangle, in which each side complements the other two, but if one is absent, the other two are unable to close the gap, since their geometric features prevent them from doing so. In the given sense, it cannot be denied that national priorities are likely to be more attainable with a proper policy on the regional level. Meanwhile, the regional events themselves are becoming more determined by the process of globalization, since even as a region, the countries of Central Asia will still remain small from a global perspective. In this case, it becomes the primary task of national and regional policies to mitigate the appeals of globalisation, while also moving smoothly towards the international community. This, however, will require a balanced approach with additional studies of the possible impact of globalisation on Uzbekistan's general development.

⁵⁵⁰ The official view in Uzbekistan was outlined by a high-ranked government official who specifically noted the following: *“Certainly, we perfectly realize that Central Asia is among the vital interests of the world’s most powerful countries which, to some extent, show their interest in regional integration and cooperation. Moreover, these countries possess necessary resources and abilities to act as guarantors of stability and steady development of the entire region. However, Uzbekistan acts strongly against the so called «a new round» of geopolitical competition in the Central Asian region. We are for an open, mutually beneficial cooperation among all respective parties concerned”*. From the speech of the First Deputy Minister of Foreign Affairs of Uzbekistan Mr. V. Norov at the Briefing “Uzbekistan’s Role in Regional Integration and Ensuring Regional Security”, 8 October 2003. <http://www.eias.org/luncheons/uzbekperspective/norov.pdf>

(a) Central Asian Selected Industries in Total Soviet Output and Trade, 1990

	USSR, total	Uzbekistan, %	Kazakhstan, %	Kyrgyzstan, %	Tadjikistan, %	Turkmenistan, %
Electricity, bln.kWh	1726	3.3	5.1	0.8	1.1	0.8
Oil, mln.tons	571	0.5	4.5	0	0	1
Natural gas, bln.m ³	815	5	0.9	0	0	10.8
Coal, mln.t	703	0.9	18.7	0.5	0.1	-
Steel, mln.t	154436	0.7	4.4	0	0	0
Import (export) of buses	86322 (86322)	2.7 (0)	4.5 (0)	1.4 (1)	1 (0)	0.7 (0)
Import (export) of trucks	773881 (773881)	2 -	4.8 -	0.8 (3.1)	0.5 (0)	0.4 -
Import (export), mln.USD, 1991		600 (1300)	800 (1600)	50 (600)	300 (500)	100 (400)

(b) Central Asian Republics in the Soviet Trade System, 1990

	USSR, total in mln.roubles	Uzbekistan, %	Kazakhstan, %	Kyrgyzstan, %	Tadjikistan, %	Turkmenistan, %
Total export:	234179,7	4	4	1.1	1.1	1.1
-out the USSR	45632,8	2.6	2	0.1	0.7	0.4
-inter- republican	188546,9	4.3	4.5	1.3	1.3	1.3
Total import:	302644,1	4.8	5.9	1,4	1.4	1.2
-out the USSR	114097,2	2.5	3.1	0.9	0.7	0.6
-inter- republican	188546,9	6.3	7.6	1.7	1.8	1.6
Trade balance:	-68464,4	-	-	-	-	-
with world	-68464,4	-	-	-	-	-
with Union's republics	0	-	-	-	-	-

Source: Mangott G. (Hrsg.) Buerden Auferlegter Unabhaengigkeit. Neue-Staaten im post-sowjetischen Zentralasien. Based on Tables on pp.151-158.

Socio-Economic Potential of Uzbekistan in the First Years of Independence:
Strengths and Weaknesses

	Advantages	Disadvantages
Population	High ratio of young motivated people to support transformation process. There was no problem of “aging population”.	High population growth rates which exerted pressure on the existing economic difficulties (socially vulnerable long families, unemployment).
Industry	The republic did not suffer huge losses related to high integrity with the former Soviet economy.	The share of industry in the economy was lower than in other republics, with low level of diversification and high ratio of obsolete equipment which in turn needed both modernization and replacement.
Trade	There were a few commodities (gold, cotton) which could be easily sold on world markets.	Industrial sector activities and domestic consumption in general were highly dependent on imports.
Agriculture	The sector had a strong potential to meet the requirements of both domestic and external markets as well as to raise standard of living in the future.	Simultaneously, it was very large and therefore, functioned inefficiently. Reforms in the sector were much needed even in the Soviet time.
Macroeconomy	Moderate external debt*	Underdevelopment of financial markets and absence of convertibility of national currency.
Human capital	High life expectancy and literacy indicators comparing to other countries with the similar income level.	Abrupt decline in public financing for healthcare and education.

Source: UNDP (1999). Uzbekistan. Human Development Report. p.13, adapted version.

* In 1992 Russia took on the entire debt of the former USSR on the condition that it also assumed the whole USSR's external assets.

(a) Selected Macroeconomic and Social Indicators in Various Years

	Growth in Real GDP			Inflation			HDI			Population under poverty line, %	
	1992	1993	1994	1992	1993	1994	1992	1993	1994	1987-88	1993-1994
Uzbekistan	-11	-2	-4	645	534	1568	na	0.676	0.675	24	29
Kazakhstan	-3	-9	-13	1381	1662	1892	0.788	0.752	0.697	5	50
Kyrgyzstan	-19	-16	-20	855	772	229	0.689	0.664	na	12	76
Tadjikistan	-29	-11	-19	1157	2195	350	na	na	na	na	na
Turkmenistan	-5	-10	-17	493	3102	1748	0.873	0.746	0.697	12	48

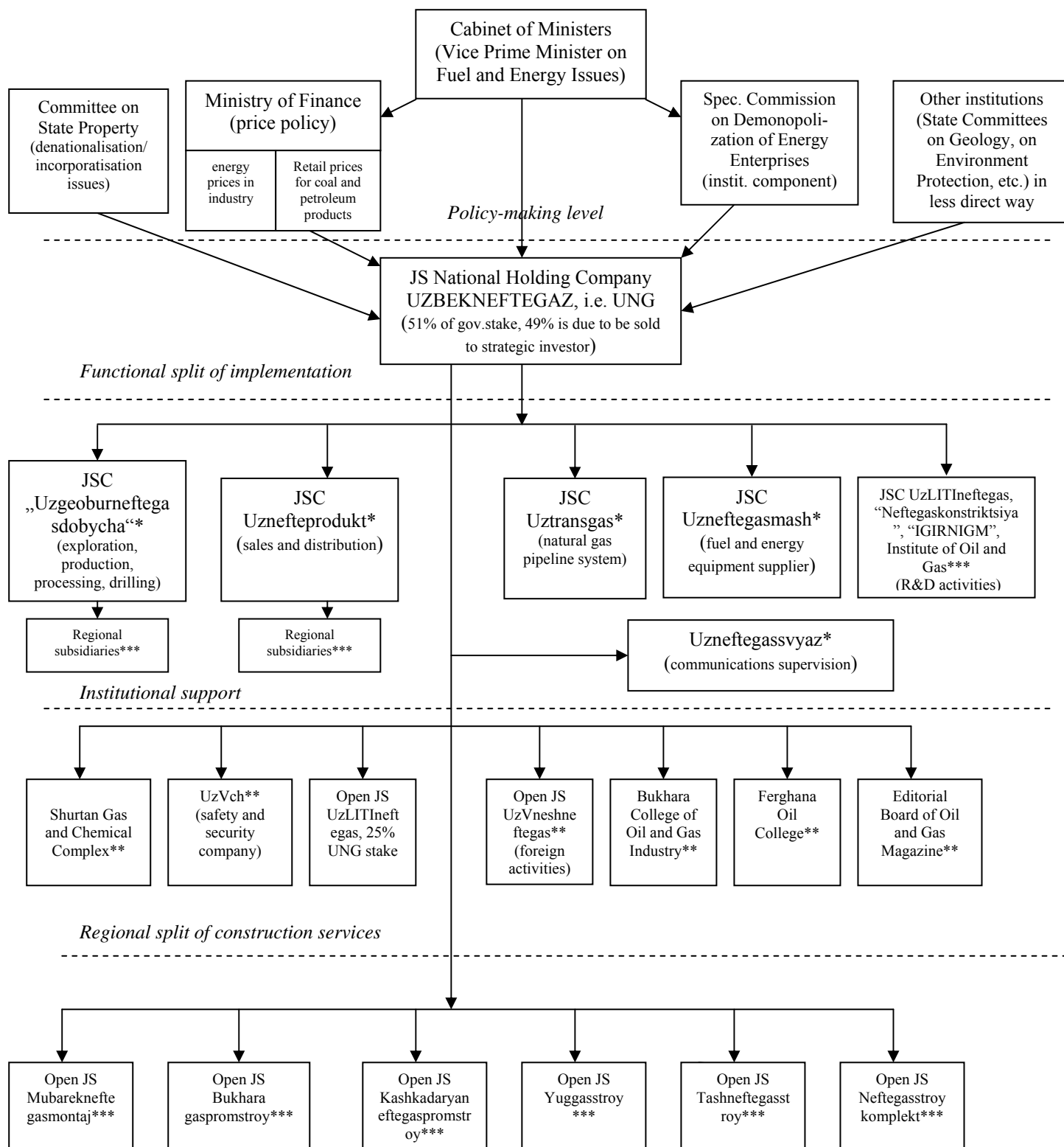
Source: EBRD Transition Update, April 2001; National Human Development Reports for 1995-99.

(b) Progress in Institutional Reform

Country	Aggr. EBRD index	EU index of institutional development	EU index of political development	World Bank classification	Private sector share in GDP (%), 1995	Change in private sector share of GDP (% points) 1969-95
Estonia	2.9	3	2.9	3	65	55
Belorus	1.8	1.4	1.3	1	15	10
Turkmenistan	0.8	1.4	1.3	1	15	10
Russia	2.3	2.3	2.1	2	55	50
Latvia	2.4	2.6	2.5	3	60	50
Kyrgyzstan	2.5	1.8	1.7	2	40	35
Lithuania	2.5	2.5	2.5	3	55	45
Kazakhstan	1.8	1.9	1.6	2	25	10
Ukraine	1.9	1.8	1.9	1	35	30
Azerbaijan	1.3	1.6	1.5	0	25	20
Moldova	2.3	2.1	2.1	2	30	25
Armenia	1.8	1.8	1.9	0	45	37
Tadjikistan	1.3	1.3	1.2	0	15	10
Georgia	1.7	1.8	1.8	0	30	12
Uzbekistan	2	1.5	1.3	1	30	25

Note: EBRD classification (on a scale of 1-4.5) and the World bank's classification (on a scale of 0-4) with higher figures reflecting better reforms.

Source: Transition, 7, July-August 1996.

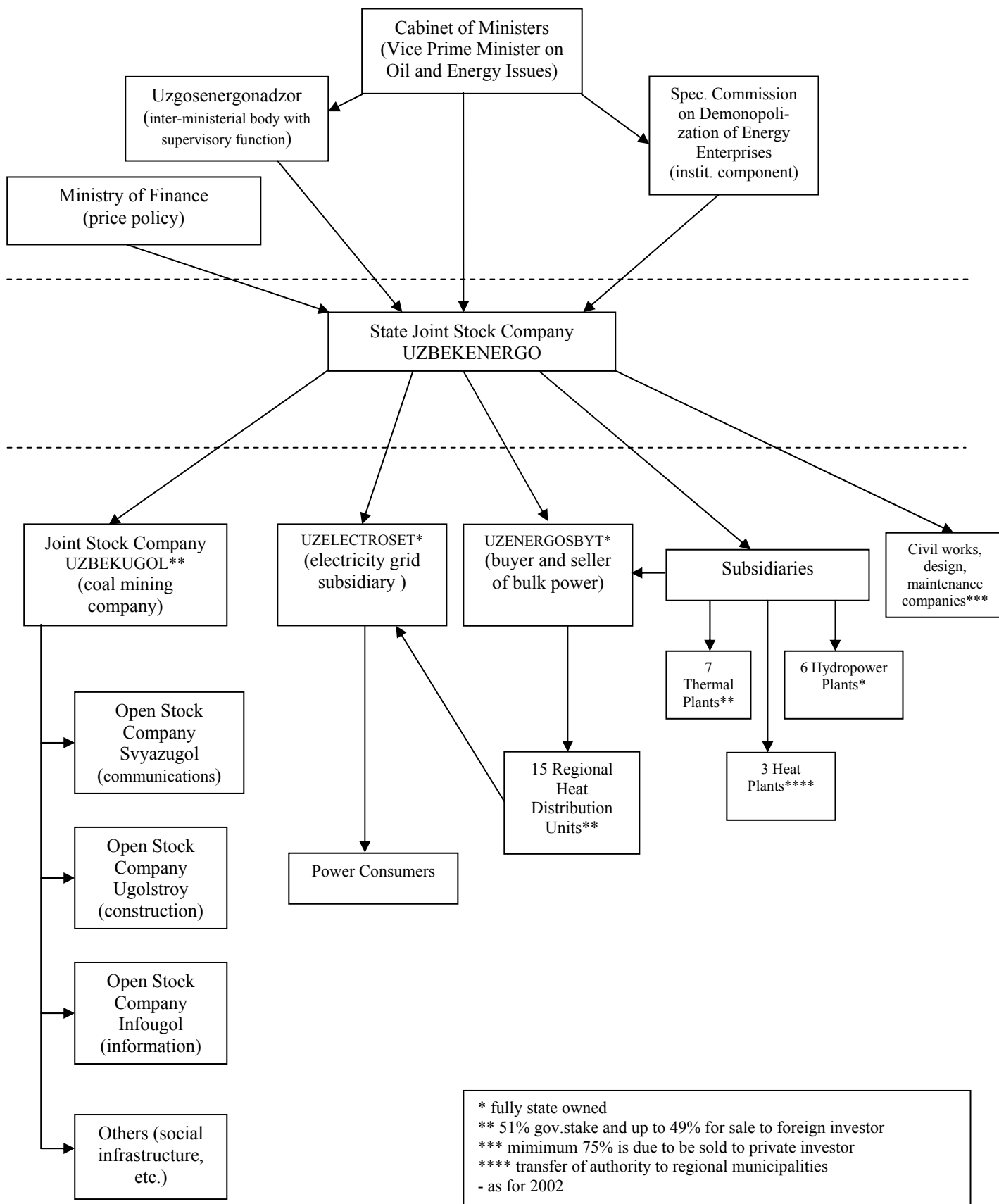
Organizational Structure of Decision-Making in Oil and Gas Industry, 2004¹

* with 51% of government stake, at least 39% - for private investment, and rest – employees stake, as for 2002

** 100% state owned, as for 2002

*** a) 100% owned by UNG or other JSC; or b) with 51% of the higher-level JSC stake, at least 39% - for private investment, and rest – employees stake; or c) 25% - for JSC at former levels, 26% for employees, 25% - for foreign investors, 24%-for free sale; or d) joint ventures, as for 2002.

Scheme of Power Supply and Decision-Making in Energy and Coal Mining Industry, 2003¹



¹ public utilities is not a part of this system, but among the biggest consumers. They are governed separately through another Vice-Prime Minister administration for public utilities, transport and construction industry, and by an ad hoc state agency UzKomunxizmat (public utilities).

The Energy Deficiencies of the Soviet system

It is well-known fact that the world oil crisis of 1973 and 1979 played a key role in the development of new trends in the energy sphere worldwide. If between 1960 and 1973 OECD countries total energy consumption grew at a brisk of 4,8% per year (just slightly slower than GDP which was growing at an average 5% per year), during the 1973-1990 period the growth rate dropped to 0,7%, while GDP slowed to only 2,6%. It meant that traditional point of view on economic growth on the basis of extensive resource consumption was undermined. The industrialized countries, the largest consumers of energy at that time, significantly redeveloped their energy strategy under the circumstances of the world trends.

Compared to them, for the Soviet Union, even though the growth rate of aggregate energy consumption began to drop only with about a half-decade lag after reorientation of western economies, the drop in the growth rates was substantially less. Even before the first oil shock, the soviet energy system was substantially overwasted. The most adherent characteristic of the planned system was its considerable energy-intensity. In 1970, despite its much lower level of economic development, the Soviet Union was consuming 30% more energy per dollar of GDP than the average of OECD countries, and 70% more than Japan. The only exclusion was the USA, which consumed 10% more energy than the Soviet Union. In 1980, the planned system consumed already 2 times more energy per unit of GDP than the OECD countries on average, and 3 times more than Japan. In 1988, Soviet industry, for example, consumed 37% more energy than US industry, even though the final output of goods produced by Soviet industry was only about one third of that of the USA. Therefore, according to some estimates, with 1980 the rate of consumption of energy resources, the Soviet economy overconsumed 60% of energy resources in the beginning of 1990s. In other words, these figures could be interpreted as 520 mln.tonnes of oil equivalent or 6,5% of the world consumption of primary energy, or half of total oil production by OPEC, or 25% higher than total energy consumption of Japan in 1990s.

The analysis showed that the Soviet energy sector was highly inefficient. The following, both economic and political, reasons are summarized to explain the main sources of the critical events in the energy sector:

- Extensive methods of encouragement of economic growth. Energy abundance of the economy in international perspective made the planners to be wasteful rather than being efficient. The overall principle of “primacy of quantity over quality” exacerbated inefficiency and stagnation of the Soviet economy since 1970s and till the mids of 1980s;
- Low energy prices of energy resources which did not reflect direct costs (resource and capital rent), let alone other costs (environmental, for instance). The average cost for the specific industry plus arbitrary profit margin extremely undermined sound atmosphere in the energy sector;
- All prices were strongly regulated by the government, because energy sector was the state monopoly. The domestic prices did not reflect world energy tendencies, since they were isolated from the world prices. The government determined domestic production and consumption substantially proceeding from its internal and external political interests (energy and resource intensive military complex needed relatively cheap resources to keep pace within arm race during the Cold War; Soviet Union was a large supplier of energy resources both to socialist camp and to the third world countries);
- Systemic shortcomings. That implied traditional preoccupation with gross output; the relatively weak managerial incentive to minimize costs in the absence of genuine profit motives and competitive performance pressures; the anti-innovative bias with a profoundly non-competitive and permissive economic development; soft budget constraints and distorted prices;
- Deceleration of technological progress and the exhaustion of overall production capacities in the entire sector.

Source: Dobozi I. (1992) Soviet Energy Policy and Consumption in the 1990s: the Need for New Thinking and Price Reform.

(a) Comparative Data on Energy Potential of Central Asian Republics

Energy resources	Kazakhstan		Kyrgyzstan		Tajikistan		Turkmenistan		Uzbekistan		Central Asian region	
	2000	2020	2000	2020	2000	2020	2000	2020	2000	2020	2000	2020
Coal*, bln tons	34,1	34,1	1,34	1,27	0,67	1,0	Insig.	Insig.	2	2	38,11	38,37
Oil*, mln tons	2760	2760	11,5	10,2	5,4	10	75	75	350	350	3261,9	3205,2
Gas*, bln cu.m	1841	1841	6,54	6,2	9,2	10	2860	2860	2000	2000	6716,74	6717,2
Uranium**, ths tons	601	601	Insig.	Insig.	Insig.	Insig.	Insig.	Insig.	83,7	83,7	684,7	684,7
Hydropower***, bln kWh/year	27	27	52	99	317	317	2	2	15	15	413	460
RES, incl. small hydro, bln kWh/year	66	66	Insig.	Insig.	18,4	18,4	n/a		n/a	n/a	84,4	84,4

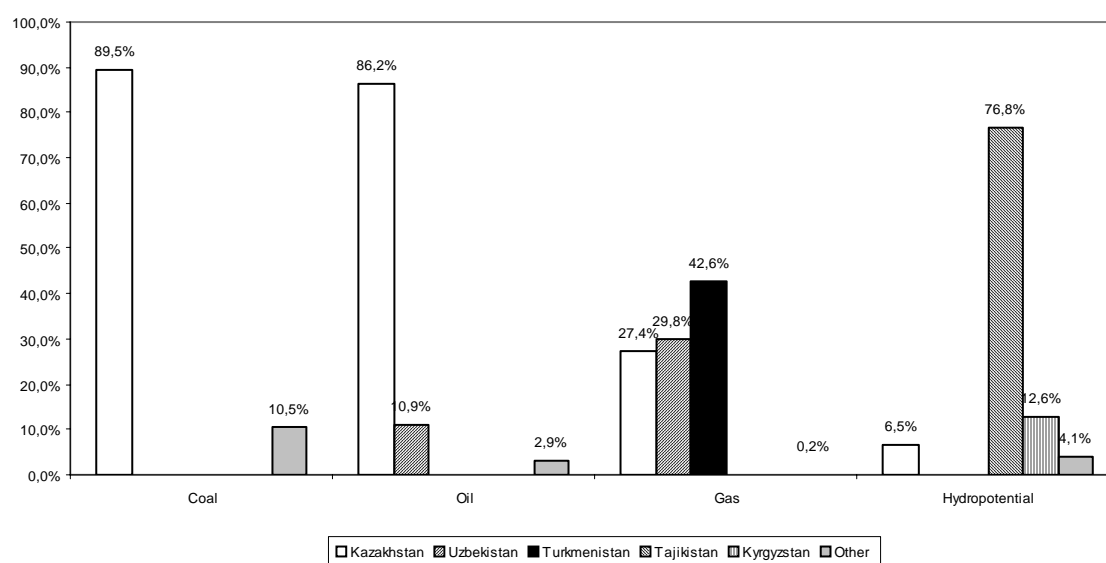
* Figures for coal, oil and natural gas refer to proven recoverable resources.

** Uranium resources estimated by the World Energy Council with mining costs at below US\$ 130/kg

*** Economically viable potential (for Uzbekistan – technological hydroelectric capacity)

Source: Diagnostic Report on Energy Resources in Central Asia

(b) Distribution of Proven Recoverable Energy Reserves and Hydroelectric Potential in Central Asia



Source: Diagnostic Report on Energy Resources in Central Asia

Energy Production and Consumption in Selected Years

Years	Production			Consumption		
	1992	1997	2002	1992	1997	2002
	Total primary energy, million tce*					
Kazakhstan	127.0	92.7	143.7	102.9	60.5	38
Kyrgyzstan	2.8	0.8	1.8	4.3	3.2	2.9
Tajikistan	2.2	1.8	2	6.5	5.3	4.3
Turkmenistan	76.0	22.5	80.5	24.5	16.2	15.6
Uzbekistan	57.2	72.2	83.68	61.3	62.6	57.7
Total	265.2	191.0	311.68	199.5	147.8	118.5
	Coal, million tce					
Kazakhstan	127	72.6	86**	86.00	56.00	58**
Kyrgyzstan	2.2	0.5	0.5	4.00	0.72	0.89
Tajikistan	0.2	0.02	0.036	1.00	0.08	0.13
Turkmenistan	0	0	-	0.70	0.00	-
Uzbekistan	4.7	2.9	2.74	6.00	3.00	2.7
Total	134.1	76.02	89.28	97.7	59.8	61.72
	Oil and Gas Condensate, million t					
Kazakhstan	25.8	25.8	51.5**	17.37	9	8.03**
Kyrgyzstan	0.1	0.1	0.5	1.73	1.12	0.12
Tajikistan	0.06	0.03	0.016	1.17	0.70	0.98
Turkmenistan	5.2	4.8	8.2	6.84	4.70	2.6
Uzbekistan	3.3	7.9	7.1**	9.22	7.50	7.5
Total	34.46	38.63	67.32	36.33	22.02	19.2
	Natural Gas, billion cubic meters					
Kazakhstan	8.1	8.1	14**	17.3	6.6	16**
Kyrgyzstan	0.1	0.2	0.016	1.9	0.99	2.02
Tajikistan	0.01	0.04	0.033	1.8	1.7	1.3
Turkmenistan	60.1	13.7	53.4	10.8	7.4	7.5
Uzbekistan	42.8	51.2	57.5**	41.3	45.1	55.4
Total	111.2	73.06	124.95	73.1	61.792	82.22
	Electricity (Hydro-energy), billion kWh					
Kazakhstan	86 (6.86)	52 (6.5)	63.7**	96.9	57.1	62**
Kyrgyzstan	11.9 (9.3)	12.64 (10.9)	11.9	9.80	6.6	10.5
Tajikistan	16.8 (15.9)	14 (13.7)	15.2	18.00	16.2	16.03
Turkmenistan	13.2 (0.4)	9.5 (0.49)	10.7	8.10	7.9	10.1
Uzbekistan	50.9 (6.3)	46.1 (5.8)	49.3**	49.00	48	48
Total	178.8 (38.72)	134.24 (37.39)	150.8	181.8	135.8	146.63

* data on a net calorific value basis; ** 2003

Sources: Diagnostic Report on Energy Resources in Central Asia; ADB Key Indicators 2003; Energy Information Administration; CIA World Fact Book 2003; IEA Statistical data base.

Oil and Natural Gas Infrastructure in Central Asia: Existing and Envisaged

Main Energy Pipelines With Central Asian Involvement

Name	Route	Annual Capacity	Length	Estimated costs and investment	Status	Main parties concerned
Oil projects						
Caspian Pipeline Consortium (CPC)	Tengiz oil field (Kz) to Black sea terminal in Novorossiysk (Ru)	Currently: 28 mln.t Plans: up to 67 mln.t	Almost 1760 km	More than US \$4 bln.	Kz exported 15 mln.in 2003, plans for 20 mln.in 2004	Russia, Kazakhstan
Atyrau-Samara pipeline	Atyrau (the only seaport in Kz) to Samara (Ru) linking the Russian pipeline system	Currently: 15 mln.t Plans: 25-30 mln.t by 2006	765 km	About US \$37.5 mln.	In 2002 an agreement was signed to export current amounts in the next 15 years	Russia, Kazakhstan
Kenkiyak-Orsk	Aktobe fields (Kz) to the Orsk refinery (Ru)	6.5 mln.t			Kz agreed to swap 2,5 mln.t of its oil annually to Russian oil from Omsk (Rs) for its Pavlodar refinery	Russia, Kazakhstan
Aqtau-Novorossiysk	Western Kz via Aqtau seaport (Kz) to Makhachkala (Caspian port in Russia), linking to Makhachkala-Tikhoretsk-Novorossiysk pipeline to Russian Black sea oil terminal	Aqtau freight facilities allow to handle more than 8 mln.t after upgrade in 2002			Currently used for the shipments of about 2.5 mln.t of Kazakh oil	Russia, Kazakhstan
Kazakhstan-Iran oil swap scheme	Oil from Aqtau (Kz) to the Iranian ports in the Caspian sea, while Iran commits to export the same amount from its ports in Persian Gulf.	Currently more than 1 mln.t			Plans to increase exports by another 1.5 mln.t if two oil reloading terminals in Iran with a volume totaling 150,000 tons are built	Kazakhstan, Iran
Baku-Ceyhan ("main export pipeline")	Baku (Az) via Tbilisi (Ge) to Ceyhan (Tr), terminating at the Ceyhan Mediterranean sea port	1 stage: 25 mln.t 2008-up to 50 mln.t	1740 km	Min.US \$3 bln.	Construction is underway to be completed in 2005; Kz is contemplating to supply 20 mln.t from its Kashagan oil field via Caspian to Baku	Kazakhstan, Azerbaijan, Turkey, the USA, the EU (contesting project to CPC)
Central Asia Oil pipeline	Kz via Tu and Afghanistan to Pakistan	Plans: up to 50 mln.t	1800 km	US \$2.5 bln.	Memorandum of understanding signed by the countries; project stalled by regional instability and lack of financing	Four Signatories plus the USA

Kazakhstan-Turkmenistan-Iran pipeline (economically the most viable)	Kz via Tu to Kharg Island (Iran) on Persian Gulf	Plans: up to 50 mln.t	1600 km	US \$ 1.2 bln.	Under feasibility study by TotalFinaElf; process stalled for political reasons	Kazakhstan, Turkmenistan, Iran
Trans-Caspian oil pipeline	Aqtau (western Kz) to Baku (Az), could extend to Ceyhan	na	650 km	US \$ 2-4 bln. (if to Ceyhan)	currently used by both parties (Kz and Az)	Kazakhstan, Azerbaijan, Turkey, the USA (contesting project to CPC)
Kazakhstan-China oil pipeline:	Aktyubinsk (Kz) to Xinjiang (Ch)	20-50 mln.t	3000 km	US \$3 bln.	Agreement concluded in 1997 between Ch and Kz.	Kazakhstan, China
1.phase is Kenkyiak-Atyrau pipeline	Fields in Western Kz are linked to CPC and Atyrau-Samara pipelines	In 2003- 6 mln.t; In 2004-10 mln.t; 2006 - 14 mln.t	450 km	US \$160 mln.	Opened in spring 2003 and currently oil exports in Western direction	
2.phase is Atasu-Alashankou pipeline (first export route not crossing Russia)	From a railroad loading rack in Atasu (Kz) to the Chinese border at the Druzhba-Alashankou (Ch) railroad terminal	2006 – 10 mln.t; 2011 – 20 mln.t	988 km		Construction works began in 28 Sept 2004	
Gas projects						
Central Asia-Center pipeline	Tu and Uz via Kz to Saratov (Ru) linking to the Russian natural gas pipeline system	Currently up to 50 bln.m ³ Plans for 90 bln.m ³ during the next decade		About US \$1,5 bln.	Upgrading has been made in the Kazakh part; commitments by Ru to upgrade other parts too	Turkmenistan, Uzbekistan, Kazakhstan, Russia, Ukraine, possibly the EU
Bukhara-Ural pipeline	From Bukhara gas region (Uz) to Yekaterinburg (Ru)	7 bln.m ³	588 km		In 2003 Kaztransgas signed an agreement with Russian company Mezhrefiongaz to supply 50 bln.m ³ from Uz and Tu via Kz to Russia within the next 5 years	Turkmenistan, Uzbekistan, Kazakhstan, Russia
Gazli-Tashkent-Bishkek-Almaty pipeline	From Bukhara region (Uz) to Northern Kg and further to Southern Kz	21,6 bln.m ³			Currently used	Uzbekistan, Kyrgyzstan, Kazakhstan
Korpezhe-Kurtkui	Korpezhe (Tu) to Kurtkui (Northern Iran), possible to Armenia	5 bln.m ³ ; plans to increase up to 12 bln.m ³	210 km	US \$190 mln.; expansion costs US \$300-400 mln.	An agreement was signed in 1997 for the deal to be valid within the next 25 years. 35% of gas supplied goes as a payment to Iran for construction works.	Turkmenistan, Iran, Armenia

Trans-Caspian Gas Pipeline	Turkmenbashi (Tu) via Baku (Az) and Tbilisi (Ge) to Erzurum (Tr)	Up to 30 bln.m ³	1650 km	US \$2-3 bln.	At the early stage	Turkmenistan, Azerbaijan, Georgia, Turkey, the USA, the EU
Transafghan gas corridor	Dauletabad (Tu) via Herat (Afghanistan) to Multan (Pakistan). Could extend to India	19 bln.m ³	1600 km	US \$ 2.5 bln.	Several high level meetings were held. Feasibility study is financed by ADB. Negotiations stalled after Pakistan had required reserves assessments in Tu in November 2004	Turkmenistan, Afghanistan, Pakistan, possibly India
Central Asia-China gas project	From Turkmen gas fields via Uz and Kz to Western China, possibly further to Japan and Korea	na	More than 7000 km, another 1500 km if to Japan and Korea	US \$ 10-12 bln., more if to Japan and Korea	No visible progress due to lack of finance and political agreements	Turkmenistan, Uzbekistan, Kazakhstan, China
Electricity						
Central Asia Interconnected Power System	National Energy systems of all the Central Asian states make up the common system, also linked to Russian power grid through Kz	over 20000 MWt, almost half of which could come from hydropower energy in Ta and Kg	na	na	Several meetings on the expert level were held to discuss the future of the system. Russia signed an agreements on imports of electricity from Ta (1,4 bln.kWh) and Kg (more than 1 bln.Kwh in summer) in 2004.	Tadjikistan, Kyrgyzstan, Turkmenistan, Uzbekistan, Kazakhstan, Russia
Batken-Kanibadom electricity line	Lines connect Kg and Ta, also allow to export to other CIS countries	na	na	na	Construction is due to be completed in March 2005	Kyrgyzstan, Tadjikistan, CIS
Central Asia-Afghanistan	Uz, Kg and Ta are main potential suppliers	Uz alone may potentially sell up to 300 GWh per year via link with northern Af	na	na	Since 2002 Uz has supplied about 2.5 mln.kWh annually in the frame of humanitarian aid. Yet power infr. in Af needs upgrading.	Kyrgyzstan, Tadjikistan, Uzbekistan

Note: Af - Afghanistan, Az – Azerbaijan, Ch – China, Ge – Georgia, Kz – Kazakhstan, Kg – Kyrgyzstan, Ru – Russia, Ta – Tadjikistan, Tr – Turkey, Tu – Turkmenistan, Uz – Uzbekistan.

Table (a). Uzbekistan's Foreign Trade Turnover, Export and Import Data

	1992	1994	1995	1996	1998	2000	2003
Foreign trade turnover, mln.\$USD	3083	5662.2	6612.6	9311.3	6816.9	6212.1	5.830
CIS (%)	na	61.2	38.4	27.6	26.9	37	32.4
rest of the world (%)	na	38.8	61.6	73.4	73.1	63	67.6
Export, mln.\$USD	1424	3087.4	3719.9	4590.2	3528,2	3264.7	3.260
CIS (%)	82	52.6	34.5	22.9	26	35.9	26.5
rest of the world (%)	18	47.4	65.5	77.1	74	64,1	73.5
Import, mln.\$USD	1659	2556.1	2892.7	4721.1	3288.7	2947.4	2.570
CIS (%)	43.7	53.3	43.5	32.1	27.8	38.2	38.2
rest of the world (%)	56.3	46.7	56.5	67.9	72.2	61.8	61.8
Balance, mln.\$USD	-235	550	827.2	-130.9	239.5	317.3	690
with CIS	na	736.6	13.9	467.1	1.6	46.6	-117.84
with rest of the world	na	-186.6	803.3	336.2	237.9	270.7	572.16

Table (b). Structure of Merchandise Export and Import in Uzbekistan, % of total

	1992	1994	1995	1996	1997	2000	2002	2003
Export								
cotton fibre	62.8	50	57.9	38.1	36	27.5	22.4	19.8
chemicals and plastic	6.07	2.4	2.9	2.4	1.7	2.9	3	3.1
ferrous and non-ferrous metals	9.22	2.7	5.6	3.5	4.6	6.6	na	na
machine and equipment	7	3.4	2.5	2.8	6.3	3.4	3.9	5.9
foodstuff	2.54	3.4	2.5	2.8	6.3	3.4	3.5	2.7
energy products	6.72	14.6	14	6	12	10.3	8.1	9.8
services	na	4.5	9.3	8.3	8.2	13.8	15.9	14.4
others	5.65	18.7	25.5	34.4	27.4	30.2	36.8	37.9
Import								
foodstuffs	46.4	31.5	18.2	29.5	19.3	12.3	12.5	9.9
chemicals and plastic	5.65	6.2	9.3	12.5	12.5	13.6	15.1	12.8
ferrous and non-ferrous metals	8.78	8.5	5.7	6.7	7.5	8.6	8	7.9
machine and equipment	5.2	16.2	47.9	35.8	45.9	35.4	41.4	44.4
energy products	13.29	13.5	1.9	1.1	0.6	3.8	1.3	2.7
services	na	0.3	5	na	7.5	8.5	10.6	10.2
others	20.68	22	12	14.3	6.7	17.8	11.1	12.1

Source: Sirajiddinov N. Uzbekistan. Put k Eksportoorientirovannomu Razvitiyu. Magazine *Mirovaya Ekonomika I Mejdunarodnye Omosheniya*, 2002, No 7; Shadiyev R. Vneshneekonomicheskaya Deyatelnost Uzbekistana: Retrospektiva i Perspektivy Razvitiya. Magazine *Halqaro Munosabatlar*, 2001, No 3; WTO International Trade Statistics 2004; Uzbekistan's Foreign Trade Reaches \$6.68 bln. in 2003, www.uzreport.com, 22 March 2004.

Domestic Prices on Selected Consumer Imports under Protectionist Policy in Uzbekistan,
late 1990s*

Merchandise Group	Index of Actual Difference, P_d/P_w (%)	Customs Rates		
		Excise on Imports (%)	Customs Duty (%)	VAT on Imports (%)
Video- and audio appliances	210	45	30	20
Grain products	156	10	20	20
Macarones	168	20	20	20
Fruit juices	198	35	30	20
Soft drinks	198	35	30	20
Bier	210	45	30	20
Perfumes	174	15	30	20
Detergent and cleaning means	180	20	30	20
Leather products	168	20	20	20
Up-wear and hat from natural fur	174	25	20	20
Carpet and carpet products	264	90	30	24
Cloth and related knitted wear (except children's wear)	174	15	30	20
Bedding	180	20	30	20
Ceramic wares	180	20	30	20
Jewelry from precious stones and metals	264	90	30	20
Furniture	174	15	30	20
Chandelier and light equipment	168	10	30	20

P_d - domestic prices, P_w - world prices

Source: Sirajiddinov N., Gulyamov R. Reforma Vneshnetorgovoy Politiki v Protssesse Liberalizatsii Valyutnogo Rynka Uzbekistana. Magazine *Halqaro Munosabatlar*, 2001, No 3.

* These differences are estimates and to show price divergencies, as a result of restrictive foreign exchange and trade policies in the country in the recent past. On the other hand, it also justifies the necessity of appropriate adjustment in trade policy after the elimination of foreign exchange restrictions on 15 October, 2003.

The Key Factors of International Investments and Credits to Uzbekistan*

Macroeconomic Factors	Microeconomic Factors	Socio-Political and Cultural Factors
<p>I. Government Policies</p> <p>a) Fiscal and Tax b) Monetary c) Financial d) Foreign Economic e) Social f) Infrastructure</p>	<p>I. Specific Factors Which Provide a Firm With Exclusively Advantageous Position on the Market</p> <p>a) Differentiation in Supply of Goods b) Market Proficiency and Management c) Technological Advancement d) Property Rights</p>	<p>I. General</p> <p>a) Political Stability and Security b) Political Behaviour in the Society c) Democratic Values</p>
<p>II. Factors of Business Cycle</p> <p>a) Growth of Exports b) Growth of GDP c) Absorptive Capacities of Host Countries</p>	<p>II. Low Production Costs</p> <p>a) Economies of Scale b) Standardization of Goods</p>	<p>II. Credibility of State Machine</p> <p>a) Confidence in government actions b) Well-educated, reform-oriented government bureaucracy c) Good governance (exclusion of red tape, bribery) d) Transparent and consistent decision-making process</p>
<p>III. Exogenous Factors</p> <p>a) Economic Growth in Main and Non-Main Trade Partners b) Stability on World Markets/World Economy c) Interest Rates</p>	<p>III. Comparative Advantages</p> <p>a) Cheap and Qualified Labor Force b) Relatively High MPC c) Sustainable and Solvent Consumer Demand d) Proximity to Domestic Consumers and Suppliers</p>	<p>III. Efficient Judicial System</p> <p>a) Rule of Law b) Sustainable Legislation c) Democratization of Courts System</p>
	<p>IV. Lower Operational Costs</p> <p>a) Taxation b) Licensing c) Infrastructure</p>	<p>IV. Environmental Issues</p>
	<p>V. Evaluation Indicators</p> <p>a) Differences in Returns b) Differences in Risks</p>	<p>V. Socio-Cultural Factors</p> <p>a) Nationality of Investors b) Cultural Mentality of Recipient Countries</p>
	<p>VI. Marketing</p>	

* In the given case, international investments include capital movements through private, bi- and multilateral channels.

Regionalism in Developing World

Reasons of Failure	Lessons
Insufficient interests of the leadership	Reinforcement of political value added from regionalism
Unpreparedness of the members to repudiate unilateral national policy measures	Prove the advantages of joint steps
Introduction of unilateral trade restrictions to behave in new liberalized conditions	Principle of reciprocity and coordination
Unfair distribution of costs and benefits	More equal allocation of costs and benefits of integration
Traditional orientation of trade toward former parent state*	Regional integration coordinates with multilateral trade system
Cultural and ideological divergences	Stronger reciprocal exchange may relieve natural estrangement
Poor tax system enforce the governments to rely upon customs receipts	Better governance and optimization of policies in the public finance area
Differences in basic socio-economic indicators (per capita income, productivity, structure of economy, etc.)	Assistance to regional development through specific programs and projects
Prevalence of import-substitution over outward development strategy	Enhancement of open door policy
Setbacks to movement of production factors	Necessity of measures to encourage factor mobility
Macroeconomic impediments (inflation, negative balance of payments, budget deficit, etc.)	Measures to keep up macroeconomic stability
Low level of integration at the outset of the integration process	Structural flexibility through higher trade specialization; improvement of the structure of trade and integration agreements

* - in former colonies

Source: Altvater E. Regionalizatsiya Mirovogo Rynka In Diter H. Regionalnaya Integratsiya v Tsentralnoy Azii. Zentralstelle fuer Wirtschafts- und Sozialentwicklung, Berlin, 1995. p.109

Intraregional Trade Operations in Central Asia (%)

Indicators	1994		2001	
	share in total trade	share in trade with CIS	share in total trade	share in trade with CIS
Kazakhstan				
export	5,8	10	3,4	11,3
import	10,6	15,3	1,8	3,5
trade turnover	8,6	13,3	2,7	6,9
Kyrgyzstan				
export	41,7	63,6	19,7	55,7
import	37,7	53,4	32,1	58,4
trade turnover	39,6	58,1	25,8	57,3
Tadjikistan				
export	9	40,2	14,2	43,6
import	47,1	72,8	35,7	45,7
trade turnover	35,1	68,3	25,2	45,1
Uzbekistan				
export	28,2	41,3	9,3	27,2
import	7,4	13,8	12,8	34,5
trade turnover	18,7	30,5	11	30,9
Central Asia				
export	15	28,7	6	19,6
import	16,2	23,1	8,6	17,3
trade turnover	15,6	25,6	7,2	18,1

Source: Ushakova N. Tsentralno-Aziatskoye Sotrudjestvo – Napravleniya Transformatsii, Magazine Central Asia and Caucasus, 2003, No 3, p.146.

Major Trade Exports in Central Asia

Exports From:	Kazakhstan	Kyrgyz Republic	Tajikistan	Uzbekistan	Xinjiang PRC
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, fruits	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.

Factor of Distance for Central Asian Exports

The Landlocked Countries of Central Asia

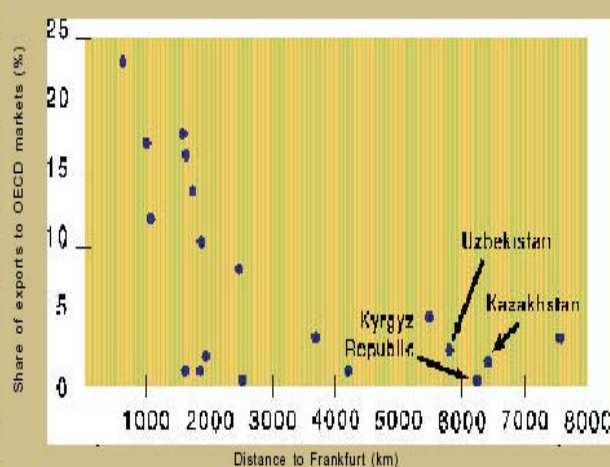
The geographic location of Central Asia inhibits the necessary communication and interchange of people that can stimulate development of new markets. It also hugely discourages foreign investment in most sectors.

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



Abstracted from Asian Development Bank, Country Economic Report, Kazakhstan, October 1997, pp. 19-22.

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.

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Hiermit versichere ich, dass ich die oben genannte Dissertation selbständig verfasst, keine anderen als die angegebenen Quellen und Hilfsmittel verwendet und sämtliche Stellen, die den benutzen Werken im Wortlaut oder dem Sinne nach entnommen sind, mit Quellenangaben kenntlich gemacht habe.

Gießen, 15.April 2005