

Central Asia Regional  
Economic Cooperation Program

# Building Partnerships for Development

Regional Cooperation Strategy and Program  
2004–2006

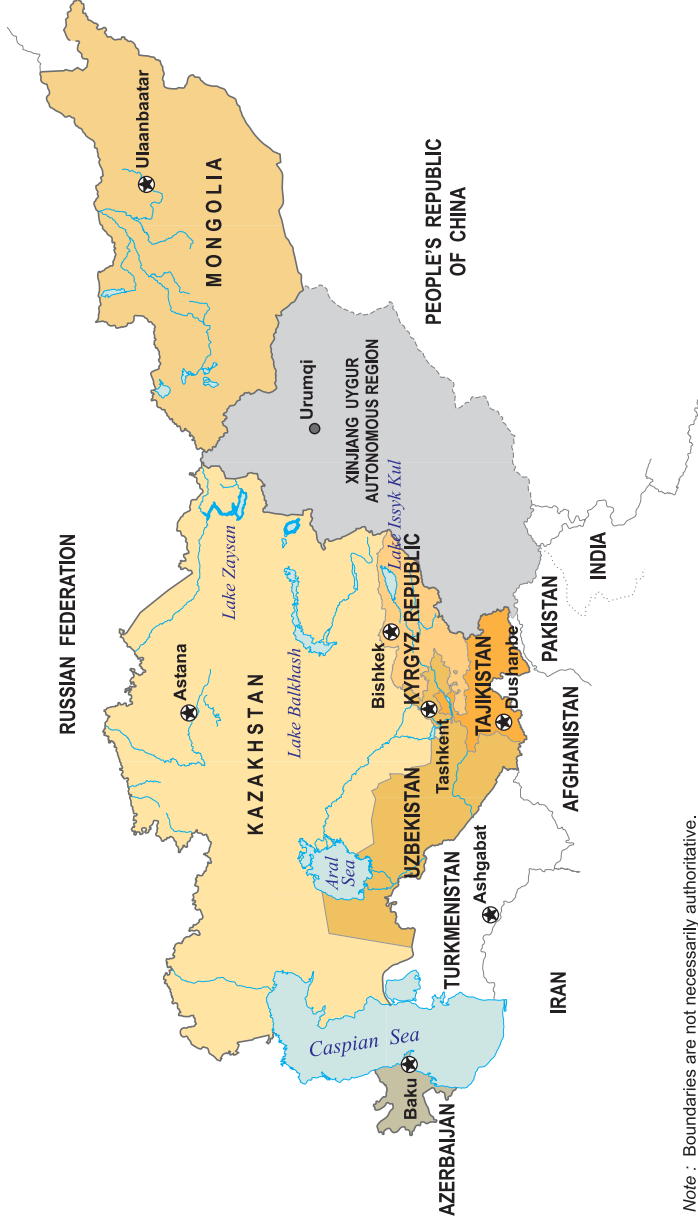
Asian Development Bank

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# Contents

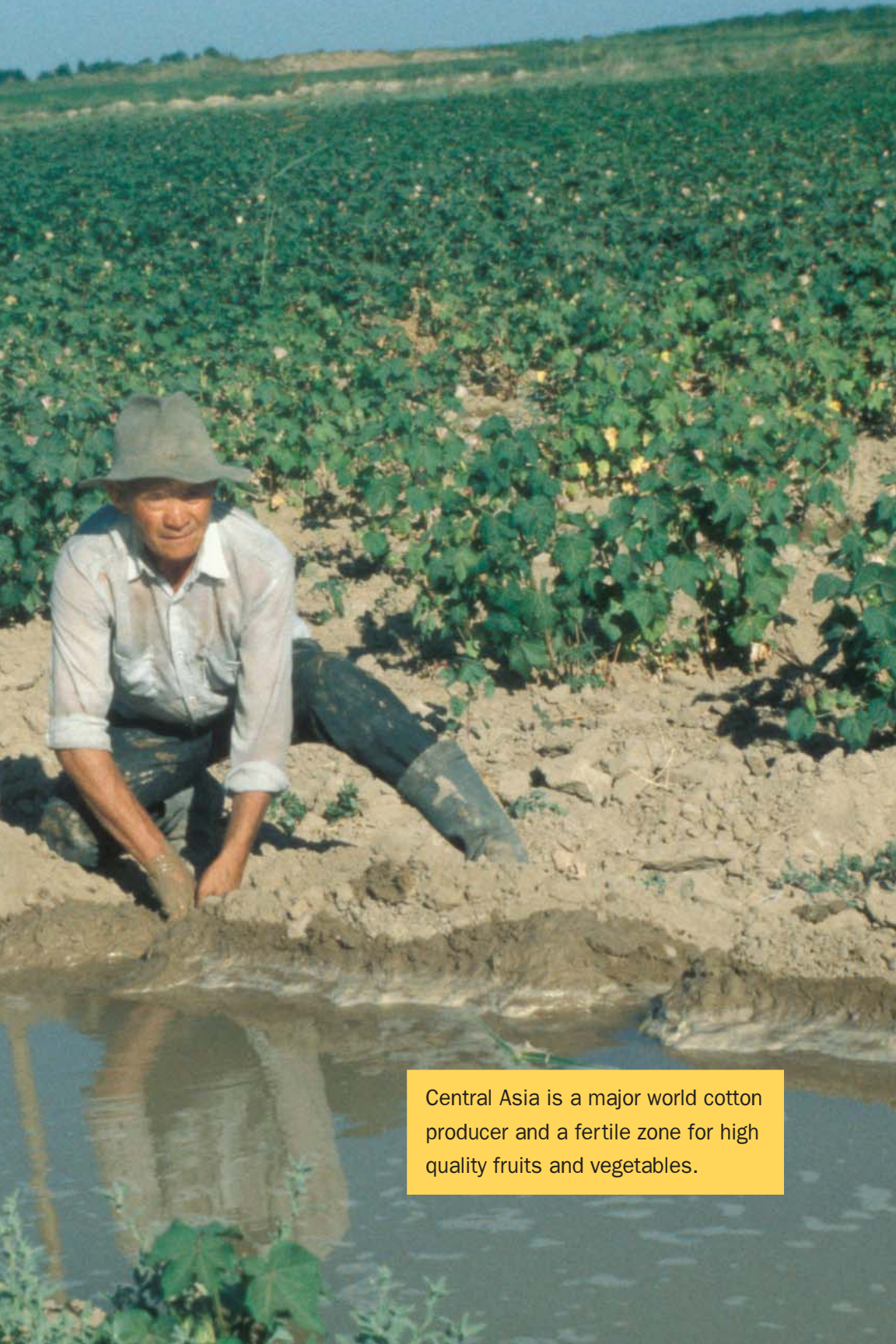
Map	4
Abbreviations	5
Executive Summary	7
About CAREC	11
Economic Trends and Prospects	13
<i>Trends</i>	13
<i>Prospects</i>	16
Regional Cooperation	19
<i>Support</i>	19
<i>Challenges</i>	20
<i>Progress</i>	20
<i>Lessons Learned</i>	22
Prospects for Achieving the Millennium Development Goals	25
Governance	30
Private Sector Development	33
Environmental Concerns	37
Donor Activity in the Central Asian Republics	39
ADB's Strategy for Regional Cooperation	41
Mobilizing Resources	47
<i>The Existing Portfolio</i>	47
<i>Overall Assistance for 2004–2006</i>	47
<i>Assistance for Strategic Priorities</i>	47
Risks	51
Appendices	53
Appendix A: Economic and Social Indicators	53
Appendix B: Regional Organizations	56
Tables and Figures	
<i>Table 1: Selected Central Asian Region Economic and Social Indicators</i>	53
<i>Figure 1: GDP Growth 1993–2003</i>	14
<i>Figure 2: Framework for Regional Cooperation in CAREC Member Countries</i>	42
<i>Figure 3: RCSP—Core Program for 2004–2006</i>	43
<i>Figure 4: Gross Official Reserves</i>	54
<i>Figure 5: Foreign Direct Investment Flows</i>	54
<i>Figure 6: Foreign Direct Investment as a Percentage of Gross Fixed Capital Formation</i>	55



Note : Boundaries are not necessarily authoritative.

# Abbreviations and Acronyms

ADB	- Asian Development Bank
CACO	- Central Asian Cooperation Organization
CAREC	- Central Asia Regional Economic Cooperation Program
CARECU	- Central Asia Regional Economic Cooperation Unit
CARs	- Central Asian Republics
EBRD	- European Bank for Reconstruction and Development
ECO	- Economic Cooperation Organization
EEC	- Eurasian Economic Community
EU	- European Union
EU-IFI	- European Union-International Financial Institution
FDI	- foreign direct investment
GDP	- gross domestic product
GUUAM	- Georgia, Ukraine, Uzbekistan, Azerbaijan, Moldova
IMF	- International Monetary Fund
MDGs	- Millennium Development Goals
NGO	- nongovernment organization
OIF	- overall institutional framework
PRC	- People's Republic of China
RCSP	- regional country strategy and program
SCO	- Shanghai Cooperation Organization
SME	- small and medium enterprise
UN	- United Nations
UNDP	- United Nations Development Programme
USAID	- United States Agency for International Development
XUAR	- Xinjian Uygur Autonomous Region



Central Asia is a major world cotton producer and a fertile zone for high quality fruits and vegetables.

# Executive Summary

**S**uccessful regional cooperation is a crucial element in the future peace and prosperity of Central Asia. Sharing their rich human and natural resources and establishing efficient transport links within the region and beyond are the keys to achieving sustainable economic growth and to improving living standards.

The Asian Development Bank (ADB) began the Central Asia Regional Economic Cooperation (CAREC) program in 1997. Member countries are the People's Republic of China (PRC), primarily the Xinjiang Uygur Autonomous Region, Mongolia, and five of the six Central Asian republics (CARs) namely Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan. Turkmenistan has not yet joined. CAREC is also an alliance of institutions that support regional cooperation including the European Bank for Reconstruction and Development, the Islamic Development Bank, the International Monetary Fund, the World Bank, and the United Nations Development Programme. This first Regional Cooperation Strategy and Program (RCSP) will focus future ADB assistance on regional cooperation.

## Rationale

Before independence, the CARs were a unified market and were integrated into the production and trading network of the Soviet economic system. All borders were completely porous. Their employment, income, and social indicators were broadly middle income. Poverty was virtually unknown. After independence, national borders and import controls converted these countries into small, segmented market economies with limited growth potential. Intra-regional trade declined by nearly 50% from 1992–2002, export earnings were disrupted, and

**Regional cooperation is required for the countries to prosper, for poverty to be reduced, and for the Millennium Development Goals to be achieved.**

**The core program will continue to focus on energy, transport, and trade facilitation projects with tangible, equitable, positive results to secure better access to outside markets and to link the region to neighboring economies such as Afghanistan.**

incomes declined precipitously. Nearly a third of the population slipped into poverty, and social indicators deteriorated sharply. Robust recovery began in 1999 with an upturn in the Russian economy reinforced by the continued boom in the PRC and significantly higher international hydrocarbon and commodity prices. Regional economic growth averaged 7.9% annually from 1999–2003, but it was largely confined to extractive sectors and to specific regions. As a result, income inequalities across the region and within countries have increased, and poverty is becoming entrenched in some places.

Poverty can only be reduced through rapid, sustained, broad-based, pro-poor economic growth through expanding exports, developing private enterprise, and increasing investment in areas currently excluded from economic gains. The share of the private sector in the gross domestic product has increased dramatically; however, most of this progress is connected with privatization rather than with private investment. Most of the significant private sector investments have been in the extractive sectors with few if any links to the rest of the economy. The near absence of foreign investor interest outside the natural resource sectors points to fundamental impediments to private sector development.

Regional cooperation is required for the countries to prosper, for poverty to be reduced, and for the Millennium Development Goals to be achieved. Regional cooperation has, however, had a mixed track record. The perception exists that benefits from regional projects do not match the efforts required to prepare them and that rewards are uncertain and unequally distributed. In addition, national sovereignty and self-reliance have taken precedence.

## The CAREC Program

Over the past 7 years, ADB's support to the CAREC program has focused on promoting regional cooperation with achieving tangible results that will establish a foundation for future progress. It has been both pragmatic and project oriented. The long-term cooperation framework has four strategic objectives, namely:



- securing access to profitable markets for exports in large neighboring countries;
- reducing transaction costs and facilitating transit and transport across the region;
- improving energy supplies for sustaining growth;
- preventing negative regional outcomes such as degradation of the environment, desertification, human and drug trafficking, and the spread of communicable diseases.


This RCSP comprises two components. The core program will continue to focus on energy, transport, and trade facilitation projects with tangible, equitable, positive results to secure better access to outside markets and to link the region to neighboring economies such as Afghanistan. Maintaining adequate capacity in these sectors is essential for private sector small and medium enterprise growth that will generate employment and reduce poverty. Regional infrastructure developed during the Soviet period is in disrepair; its rehabilitation and expansion is best undertaken regionally to attract foreign direct investment. Without regional infrastructure and streamlined regulatory frameworks for trade and transit, CAREC countries cannot expect to expand trade with larger neighboring economies.

The second component is an expanded program of regional cooperation designed to forge partnerships with other development agencies to take advantage of emerging opportunities. Over the past 10 years, the international community has actively supported initiatives for regional cooperation among the CARs. Donors have recognized the need for effective and sustained coordination and have agreed to join the CAREC program. In future, CAREC will also coordinate more closely with regional organizations such as the Shanghai Cooperation Organization and the Central Asia Cooperation Organization. Technical assistance from ADB will build a regional poverty database and will explore possibilities for intervention in areas such as water resources, land management, and environmental protection.

To date, ADB has funded five investment projects

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amounting to \$224.1 million. Since 2000, a total of \$8.7 million has been provided in 14 technical assistance grants in priority areas: \$3.1 million for regional power and gas transmission, \$3.0 million for trade facilitation and customs reform, and \$2.6 million for regional transportation projects. A series of 7 regional technical assistance projects amounting to \$6.1 million will further support project implementation. The program for 2004–2006 includes 14 projects with loans of \$295.3 million and 33 technical assistance projects worth a total of \$18.5 million. Cofinancing will be sought as needed. The principal risks to the program are lack of government ownership and scarce resources; they are significant but manageable.

An aerial photograph of a vast mountain range in Central Asia. The mountains are rugged and brownish-tan, with deep shadows in the valleys. A large, bright blue reservoir is situated in a valley, surrounded by steep slopes. The sky is clear and blue.

Glaciers atop the Central Asian mountains release water which turns downstream deserts into blossoming oases and offers vast hydroelectric potential.

# About CAREC

**T**he Asian Development Bank (ADB) began the Central Asia Regional Economic Cooperation (CAREC) program in 1997 with one regional technical assistance project that examined improving infrastructure and augmenting the availability of public goods. This led to the establishment of the CAREC unit (CARECU) in March 2000 as the focal point for promoting regional cooperation. CAREC organized its first ministerial meeting in March 2002 at which the Overall Institutional Framework (OIF) was established marking a milestone in partnership and trust. Since then, CAREC activities have been supervised and guided by the OIF headed by a ministerial committee, and CARECU has evolved into a secretariat for the OIF. Currently, CAREC members are the People's Republic of China (PRC), primarily the Xinjiang Uygur Autonomous Region (XUAR),<sup>1</sup> Mongolia, and five of the six Central Asian republics (CARs) namely Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan and Uzbekistan. Turkmenistan has not yet joined.

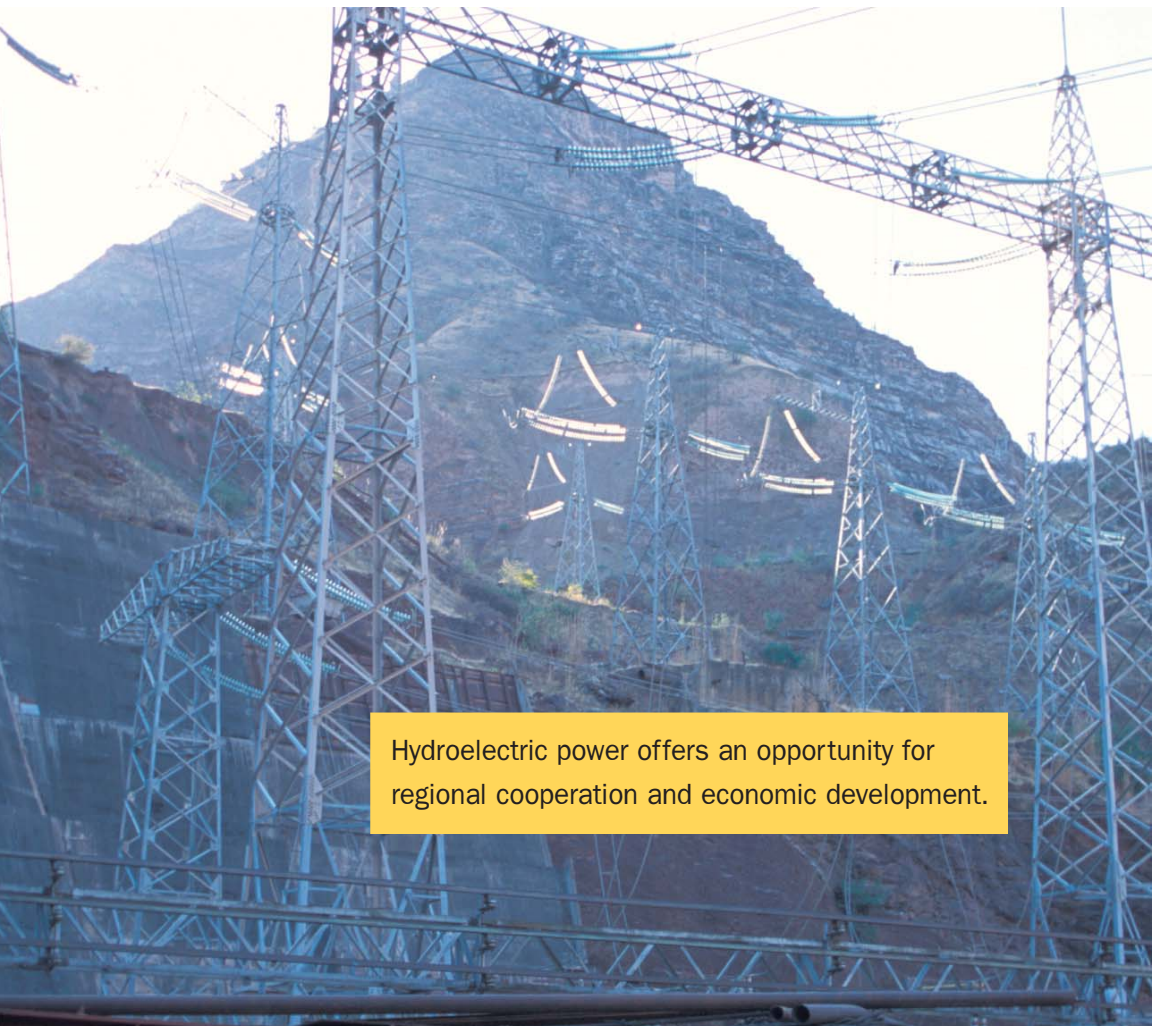
The six CARs cover a vast, landlocked landmass between Europe and Asia that measures 4 million square kilometers, an area larger than Southeast Asia. In fact, Uzbekistan, the most populous country, is one of only two countries in the world that is double land locked.<sup>2</sup> The republics share a Turkic-Persian heritage of linguistic, cultural, and social practices. They are sparsely populated by 65 million inhabitants who are concentrated in the eastern valleys and along the two main rivers—Amu Darya and Syr Darya—and their tributaries. Except for Azerbaijan, the CARs and Afghanistan share these waters and depend on them for irrigation and drinking. Most of the land is covered with desert and steppes; only 7.8% is cultivable. Average annual rainfall is low restricting the

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choice of cropping patterns and making agriculture almost entirely dependent on irrigation.

Xinjiang Uygur Autonomous Region is the westernmost province of the PRC and is geographically contiguous to Central Asia. It covers 16 million square kilometers and has a total population of over 19 million of which 47% are ethnic Uygurs. XUAR has traditionally had economic, social, and cultural relations with the CARs and was part of the famed Silk Road between Europe and Asia.

Mongolia joined CAREC in 2002. With a population of about 2.5 million and a land area equal to all of Western Europe, it is one of the most sparsely populated countries on Earth. It also is landlocked and experiences extreme climatic conditions. Only about 10% of the land is arable; the rest is covered by desert and steppes.



Hydroelectric power offers an opportunity for regional cooperation and economic development.

# Economic Trends and Prospects

## Trends

**B**efore independence, the CARs were a unified market and were integrated into the production and trading network of the Soviet economic system. All borders were completely porous. Their employment, income, and social indicators were broadly middle-income; poverty was virtually unknown. All this changed abruptly with independence. National borders and import controls converted these countries into small, segmented market economies with limited growth potential. Intra-regional trade declined by nearly 50% from 1992–2002, export earnings were disrupted, and incomes declined precipitously.

At the time of independence, the CARs faced a quadruple transition: (i) from centrally planned to market economies, (ii) towards pluralist democracies, (iii) from Soviet republics to sovereign nations, and (iv) from closed economies with extensive public ownership to integration with world markets and an increasing role for private enterprise. There was a broad consensus on the direction and content of the structural reforms required to successfully manage this multiple transition though there were differences across countries in the pace of reform and in the role of the state.

The economic performance of the CARs since independence falls into three distinct phases. The period 1991–1995 saw a sharp decline in gross domestic product (GDP) and all related indicators. The years 1996–1998 brought mild recovery and the consolidation of policy reforms. Robust recovery began in 1999.

**Before independence, poverty was virtually unknown.**

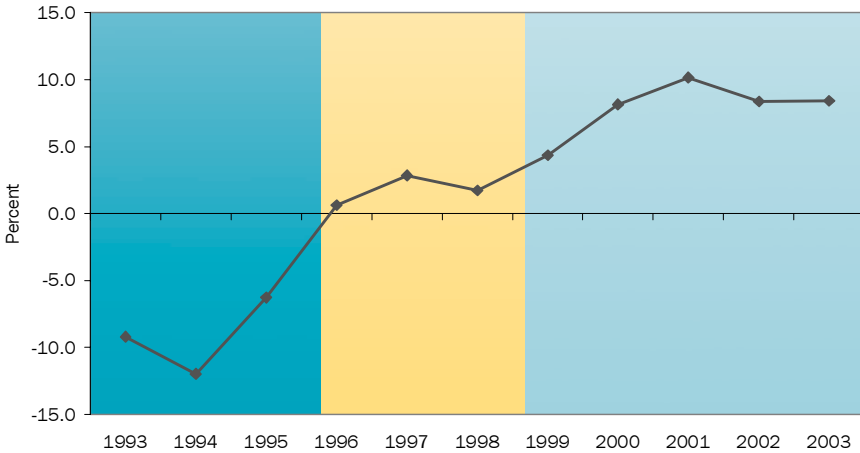
**The economic performance of the CARs since independence falls into three distinct phases.**

From 1992–1995, the GDP at constant prices declined every year for every CAR with overall declines averaging 9.1% annually.<sup>3</sup> The average per capita income in all CARs had dropped by more than 30% by the end of 1995 resulting in absolute poverty. The sharp GDP decline; the emergence of new border controls; trade and transit restrictions; and rising mutual mistrust due to border restrictions, territorial claims, and unsettled financial claims stifled efforts at regional cooperation.

During the second phase (1996-98), the region experienced a mild recovery though average GDP growth of only 1.7% per year implied near stagnation in per capita incomes given annual population growth of 1%. The Kyrgyz Republic was unable to pay for necessary energy imports and Tajikistan had to rely on emergency imports during the civil conflict, so both countries accumulated large, unsustainable external debts during this period.

The third and ongoing phase (since 1999) has seen a sustained recovery that has been reinforced by the continued boom in the PRC, an upturn in the Russian economy, and a marked rise in international commodity prices. The region’s average GDP growth for this period

**Figure 1: GDP Growth in Central Asia 1993–2003**



Source: World Development Indicators Online, August 2004.

was 7.9% while Russia's was 5.9%. By 2002, Kazakhstan had recovered its pre-independence GDP level, GDPs in the Kyrgyz Republic and Tajikistan were still below the 1991 levels (by 20% and 30% respectively), and those for Uzbekistan and Turkmenistan were somewhat higher (by 12% and 34% respectively). Azerbaijan's GDP at the end of 2003 was 93% of its pre-independence level. Currently, the total GDP of the six is about \$56 billion.

Even with the declines since independence, the average per capita incomes of the three major hydrocarbon exporters (Azerbaijan, Kazakhstan, and Turkmenistan) at the end of 2003 were \$1,285, substantially higher than those of low-income countries globally. On the other hand, the average per capita incomes of the three non-hydrocarbon exporters at the end of 2003, (Kyrgyz Republic, Tajikistan, and Uzbekistan) were \$389 which is below the average in South Asia (\$460) and in sub-Saharan Africa (\$450).

The external debt situation in the Kyrgyz Republic and Tajikistan remained precarious until the end of 2001 when its present value as a percentage of GDP was 112.6% and 103% respectively. There has been some relief in the last 2 years, but debt-servicing requirements are a binding constraint on capital formation and growth in both countries and have adverse impacts on regional projects because the governments cannot contribute the necessary resources.

In the PRC, the 1978 economic reforms and the open door policy have made substantial changes in the structure of the economy. GDP has increased by more than 9% per annum. Sustained, rapid economic growth has improved the living standards of the vast majority of the population and has reduced poverty. The PRC is becoming increasingly integrated into the world economy. Its external trade increased more than 30-fold from 1978 to 2003, and it has become the world's fourth largest trading nation and the world's largest recipient of foreign direct investment (FDI).

Mongolia suffered a decline in national output of only about 20.3% between 1991 and 1993. This was perhaps

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**GDP in the hydrocarbon-exporting CARs is projected to grow at 8.1% per year from 2002–2015**

due to foreign aid and to the fact there were no major disruptions in its exports of copper and cashmere. The GDP recovered subsequently and grew steadily by 2.3–4.0% from 1994–2003 except in 2000 and 2001 when it fell to about 1% due to harsh winters and a decline in world copper and cashmere prices. Per capita incomes have risen over the years and were estimated at \$457 at the end of 2003, but income distribution has worsened. Unemployment is high and is concentrated in the younger population. As a result, the poverty that emerged during the initial transition years has remained unchanged at about 36%. Moreover, the economy remains critically dependent upon climatic conditions and commodity exports that are vulnerable to volatility in world prices. Nevertheless, after more than a decade of transition and despite the external and climatic shocks, Mongolia could be said to have achieved reasonable political and economic stability.

## Prospects

GDP in the hydrocarbon-exporting CARs is projected to grow at 8.1% per year from 2002–2015 according to data from the International Monetary Fund (IMF). This is associated with investments of about 30% of GDP made possible by oil and gas sales. Progress in poverty reduction is forecast to be relatively impressive with a decrease of more than 50% in the poverty ratio during the same period. This is based on the assumption that growth will not be fully inclusive: the rate of reduction of the poverty ratio will be lower than the rate of increase in per capita income as suggested by the experience of Kazakhstan from 1995–2001. Poverty could be further reduced if economic cooperation leads to more inclusive growth.

The non-hydrocarbon exporting countries have modest prospects for growth and poverty reduction. GDP growth is projected to be 4.1% per year. Assuming that the relationship between growth and poverty reduction will be similar to that of the Kyrgyz Republic from 1998–2001 (the only country in the group for which time-series data are available), the poverty ratio for this group is projected to decline by 35% from 2002–2015.



Because of the hydrocarbon-rich countries, regional GDP growth from 2002–2015 is projected to be an impressive 7.3% per year, but this will yield a reduction in the poverty ratio of only 41%. Assuming that this somewhat optimistic growth rate can be realized, the main challenge lies in making it more inclusive among and within countries and in creating positive growth in the non-hydrocarbon exporters.

XUAR is at the forefront of economic cooperation in CAREC. The GDP at the end of 2002 was reported at 159.8 billion yuan or \$ 17.94 billion. The rate of growth was in line with the overall economic growth in the PRC at more than 8% annually pushing per capita incomes to 8072 yuan (\$972) in 2002. It has become a major producer of grain, cotton, and other cash crops. The province's industrial strength is based on its vast hydrocarbon reserves that were exploited after 1955 and now attract significant FDI. The industrial structure has become quite diversified as a result of the policy of making XUAR into one of the country's largest petrochemical bases which in turn has spurred the growth of related industries since the mid-1990s. Infrastructure is well developed with 3361 kilometers of railway lines connecting XUAR with the rest of the PRC, with Almaty in Kazakhstan, and with cities in the Russian Federation. The province reportedly has a road network of 80,900 kilometers of which 428 are expressways. The total value of foreign trade was \$2.7 billion in 2002 with manufactured goods accounting for more than 70% of exports largely destined for Central Asian and Russian markets.

The Mongolian government's medium-term strategy targets poverty reduction through higher rates of economic growth by strengthening macroeconomic, financial, and banking stability; by generating employment; by expanding domestic industries and exports; and by improving social service delivery. It is expected that from 2004–2007 an average GDP growth of about 7% will be achieved provided world copper, gold, and cashmere prices do not plummet and weather conditions are normal.

**XUAR is at the  
forefront of eco-  
nomic cooperation in  
CAREC.**



SECOND MINISTERIAL CONFERENCE ON  
CENTRAL ASIA ECONOMIC COOPERATION



ВТОРАЯ МИНИСТЕРСКАЯ КОНФЕРЕНЦИЯ  
ПО ЭКОНОМИЧЕСКОМУ СОТРУДНИЧЕСТВУ  
В ЦЕНТРАЛЬНОЙ АЗИИ

Leaders work together at the Second Ministerial Conference in Tashkent, 11–12 November 2003.

# Regional Cooperation

**F**our important economic features have a bearing on regional cooperation. First, a big divide has emerged between incomes in the hydrocarbon and non-hydrocarbon exporters. Second, income levels in non-hydrocarbon exporting countries have not only declined since independence but even after a few years of recovery are still at the lower end of the low-income countries. Third, although the CARs have achieved macroeconomic stability, significant structural reforms remain to be implemented. Fourth, the CARs have moved to the development phase in economic policy formulation. Thus, regional cooperation efforts must now address issues similar to those faced by other developing economies in reducing poverty while attempting to integrate with world markets.

## Support

There are a number of factors that support regional cooperation among CAREC members.

- They inherited public infrastructure that was established as a unified system and so requires a regional approach to rehabilitation.
- Harmonizing regulatory standards and working practices in financial markets, communications, and other investment services will facilitate private sector growth.
- Reducing barriers to intra-regional trade and transit would make the region more attractive for foreign and domestic investors.
- In some areas, communities straddle national borders and depend on cross-border trade that would prosper with regional cooperation.

**Regional cooperation efforts must now address issues similar to those faced by other developing economies in reducing poverty while attempting to integrate with world markets.**

**A number of serious problems can only be addressed by cooperating regionally.**

In addition, a number of serious problems can only be addressed by cooperating regionally. Environmental degradation is one of the most important. Degradation and desertification have reduced agriculture yields and the availability of arable land. The Aral Sea disaster is a grim reminder of the devastation that can occur without regional planning and cooperation. Trafficking in humans and in drugs are growing cross-border problems as are the spread of fundamentalism, militancy, and communicable diseases.

## Challenges

Since the end of the civil conflict in Tajikistan and the regime change in Afghanistan, the region has been stable politically. As newly independent states, however, the CARs are sensitive to any perceived threat to their sovereignty. Large ethnic minorities and long standing territorial claims and counter claims do not promote cooperation. Weak institutions and poor governance have not only been a major cause of anemic and exclusive growth but also explain the reluctance among the CARs to pursue regional projects. To successfully overcome these constraints, ADB and other development partners will have to increase and better coordinate technical assistance for capacity building.

Various other developments since independence have also weakened efforts at regional cooperation.

- There is uncertainty about the equitable distribution of gains from cooperation.
- Countries prefer to seek self-reliance and self-sufficiency for strategic goods and services.
- Smaller countries fear their larger neighbors.
- Economic policies and performance are diverging.

## Progress

Leaders in CAREC countries have recognized the importance of regional cooperation duly supported by development partners, and this has resulted in a number of initiatives and regional organizations (*See Appendix B*).

Some of the more important are: (i) the Economic Cooperation Organization (ECO); (ii) the Central Asia Cooperation Organization (CACO); (iii) the Eurasian Economic Community (EEC); (iv) the Shanghai Cooperation Organization (SCO); and (v) Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova (GUUAM). The latest in this series is the attempt in 2002 to unify Russia, Byelorussia, Ukraine, and Kazakhstan economically. This proliferation of organizations has perhaps diluted the limited managerial and decision-making capacity in the region and may have led to a degree of cynicism about regional cooperation. Also, most of these regional initiatives have been used to ensure political stability rather than to promote economic cooperation.

A notable example of successful cooperation is the agreement among the CARs to respect inherited borders and to leave populations in situ although this has resulted in sizable ethnic minorities in some. The continued operation of the Unified Dispatch Center in Tashkent for operating the regional power grid is another success. Some progress has also been made in regional efforts at combating drug trafficking, insurgency, and extremist activity. The 1998 Framework Agreement on Syr Darya water sharing and its annual renewal also represents real progress. Overall, however, progress has been modest leading some CARs to look for outside solutions. Relatively weak economic performance in the first half of the 1990s may have forced governments to concentrate on domestic issues; this can be expected to change in favor of regional initiatives.

ADB has achieved some success in regional projects for road construction, power transmission, and trade facilitation. The approach so far has been to focus on realistic projects with early, tangible results to reinforce mutual trust and to build political will. Areas and issues that are complex and sensitive have been avoided by focusing on projects that none of the participating countries opposes. CAREC has also supported projects involving two or more partners as long as the projects were integral parts of a larger regional undertaking. This

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**Leaders in CAREC countries have recognized the importance of regional cooperation duly supported by development partners.**

project-based approach has alleviated the necessity to prepare comprehensive sets of rules, protocols, and procedures before implementation and instead requires only sector regulations, trade agreements, and harmonization of practice as needed to facilitate progress.

## Lessons Learned

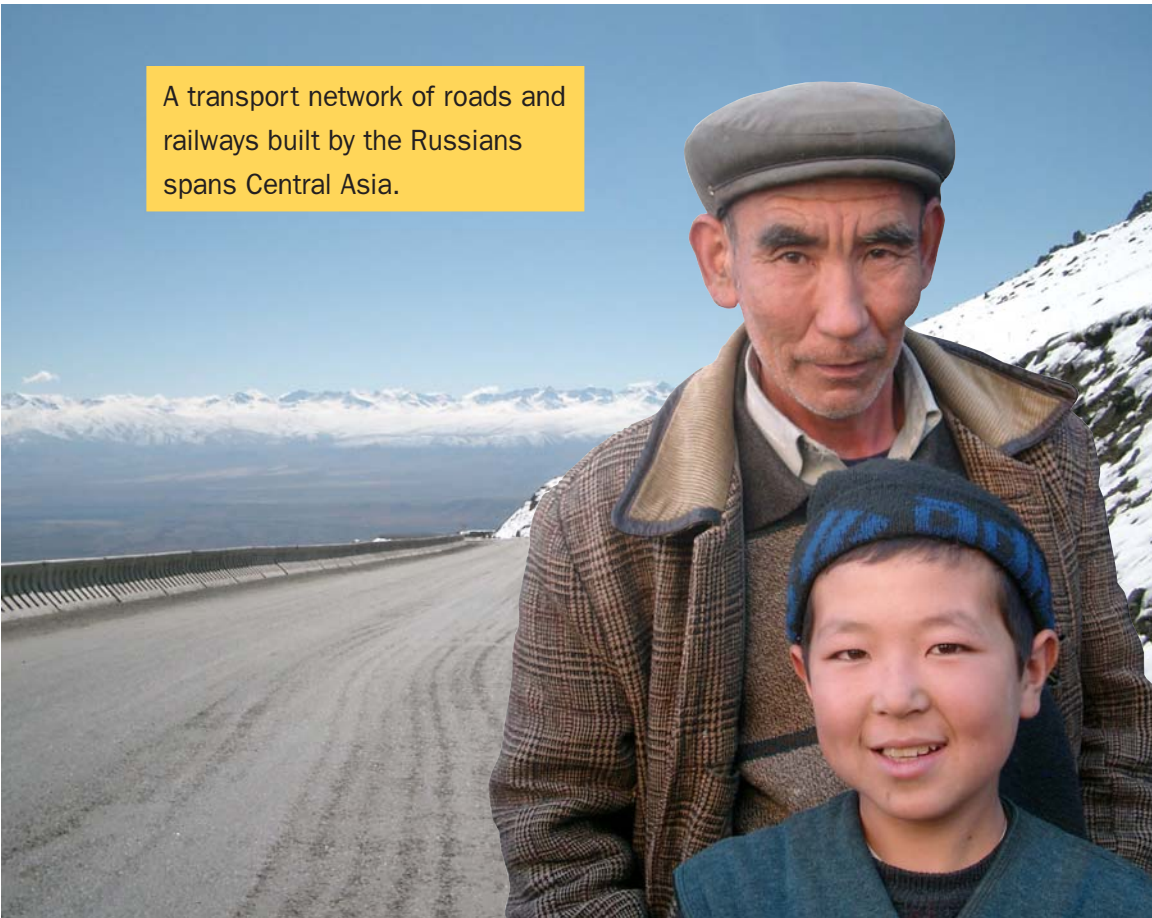
Several important lessons can be drawn from ADB's experience so far.

- ADB's role as an honest broker and provider of financial and technical assistance and its adherence to a results-oriented approach have been the keys to success.
- Consensus is necessary for building a solid foundation for regional cooperation.
- Quantifying the costs and benefits of regional projects can remove fears of loss and can highlight possibilities of shared benefits.
- To counter the perception that the benefits from cooperation are minimal and not worth the effort, it may be important to extend regional projects to Afghanistan and to neighboring countries and regions.
- The relatively poor dissemination of information about positive outcomes of regional projects and the widespread misinformation about threats from neighbors and unfair distribution of benefits must be corrected.
- Projects like transport corridors, energy trade, rehabilitation of irrigation systems, and water resource management cannot be implemented without involving all parties affected. ADB must remain engaged in the region and proactively widen consensus.

- Establishing a regional network of business and commercial entities will help to overcome the lack of strong support for cooperation.
- The relatively large number of active donors in the CARs requires proactive coordination to avoid duplication of effort and conflicting advice.
- Regional cooperation requires deeper, more sustained government commitment than that for national projects, a multi-country perspective in preparing programs and projects, balancing interests among participating countries, and intensive and regular communication both within and across participating countries. In short, regional cooperation demands better government capacity, and that will have to be built with greater coordination and resources from development partners.

**The relatively poor dissemination of information about positive outcomes of regional projects and the widespread misinformation about threats from neighbors and unfair distribution of benefits must be corrected.**

A transport network of roads and railways built by the Russians spans Central Asia.



Basic education, a building block for sustainable development, is universal in the region.





# Prospects for Achieving the Millennium Development Goals

**A**vailable data from the Soviet period point to very low levels of income poverty (Millennium Development Goal [MDG] 1) in the CARs, and to social indicators (MDGs 2-6) broadly corresponding to those in middle-income countries. It is reasonably certain, therefore, that the CARs were not suffering from widespread income poverty, social deprivation, or gross income inequality when they became independent.

Unofficial data indicate that in the first 5 years of independence (1991–1995), about 30% of the population in the CARs slipped into poverty. The worst affected were Azerbaijan, with 1.5 million internally displaced persons, the Kyrgyz Republic in which nearly two thirds of the population were poverty stricken in the worst year, and Tajikistan where prolonged civil strife resulted in almost the entire population suffering indigence and social deprivation.

The major cause of poverty at independence was the economic transition that resulted in large-scale loss of employment and therefore income and purchasing power in all the CARs. Specific components of the transition were:

- the breakdown of the Soviet Common Market Economic Association production and distribution network that resulted in the closure of a large number of industrial facilities;

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**The average incidence of poverty in the CARs is estimated at around 32% which is unacceptably high for a region that earlier had virtually none.**

- the cessation of budgetary support from Moscow that led to a near collapse in social sector expenditures;
- the breakdown of social security systems that had been maintained by state-owned enterprises and supported by state pensions that dried up due to loss of public revenues and poor governance;
- hyperinflation caused by disruption in supplies of necessary goods and loss of control over money supply as the CARs switched from the Soviet rouble to independent currencies;
- civil strife in Azerbaijan and Tajikistan and also in the Ferghana Valley;
- the migration of large numbers of skilled Russians and other nationalities to their home countries.

As a result of sustained growth between 1996 and 2002, poverty incidence in the CARs has declined, yet poverty levels remain high ranging from about 27% in Kazakhstan and Uzbekistan to 62% in Tajikistan at the end of 2002.<sup>4</sup> The average incidence of poverty in the CARs is estimated at around 32% which is unacceptably high for a region that earlier had virtually none. Moreover, rural poverty levels are now significantly higher than urban levels as agriculture has had to absorb many poor, urban, unemployed pensioners without a corresponding increase in farm or off-farm employment. Income disparities and poverty are pronounced and are concentrated in areas such as the Ferghana Valley; the border regions of Kazakhstan; the Kyrgyz Republic and Tajikistan; in Karkalpakstan and Dashoguz provinces in Uzbekistan and Turkmenistan respectively; and among internally displaced persons in Azerbaijan.<sup>5</sup> Regional disparities have become noticeable as resource-rich areas have attracted new investment pushing incomes ahead of other regions. This was most marked in the oil-producing regions of Azerbaijan and Kazakhstan and in capital cities (like Ashgabat, Astana, and Bishkek) that received a disproportionate share of public and private investment.

All these countries had high levels of social development at independence. Literacy was universal. Education

was nearly universal at primary (MDG-2) and secondary levels, and approximately 30% of students went on to enter institutions of higher education in the Soviet Union or in Eastern Europe. There was no gender discrimination (MDG-3) in education. Similarly for health care, there was nearly universal free coverage for primary services and free access to tertiary and specialty hospitals although waiting periods were long. Social protection for the elderly was nearly universal although modest. There were few, if any, urban slums.

There has been a perceptible decline in gender balance in access to both education and health facilities since independence. The CARs have been able to maintain near-universal literacy although some gender bias against women is beginning to emerge. Uzbekistan and Tajikistan, however, seem to have improved literacy since independence, especially for women. Gross enrollment has been maintained at near-universal levels both for primary and secondary education with hardly any gender bias. There is, however, marked decline in access to childcare facilities at the preschool level,<sup>6</sup> and there are disconcerting declines in tertiary enrollment in Azerbaijan, Kazakhstan, Tajikistan, and Turkmenistan. In contrast, tertiary enrollment has increased in the Kyrgyz Republic and Uzbekistan. Education curricula and testing need to be standardized and brought in line with the needs of the market.

Life expectancy at birth—widely regarded as a good overall indicator of health and nutritional conditions—has been declining in the CARs. Infant mortality improved for all except Kazakhstan.

Under-five mortality rates (MDG-6) improved since independence except in Azerbaijan, the Kyrgyz Republic, and Tajikistan where they worsened before improving again. Maternal mortality (MDG-5) seems to be deteriorating in almost all CARs except Uzbekistan where it has been almost halved since independence. Mother and child nutrition has also declined across the region. Unfortunately, there has been a sharp increase in communicable diseases such as tuberculosis and HIV/AIDS (MDG-6).<sup>7</sup>

**There has been a perceptible decline in gender balance in access to both education and health facilities since independence.**

**The significant decline in social indicators in the CARs shows a need to adapt the MDGs by changing the base year to the year of worst poverty and social development.**

The spread of HIV/AIDS is related to rising drug use that often correlates with rising income poverty. These trends could also be a serious consequence of the marked decline in public expenditure on health in the CARs since independence.


Considering their per capita incomes, the CARs still have impressively high levels of human resource development.<sup>8</sup> This is partly because of the socialist legacy and is partly an upward bias in official statistics. Despite the latter, high poverty levels and overall regression in social indicators are visible across the region. The oil boom in Kazakhstan over the last 4 years may have reversed this trend to some extent, but surveys in several other CARs suggest that access to education and health continues to deteriorate and also often depends on payment of unofficial fees that the poor cannot afford. This further exacerbates social inequalities and creates structural impediments to achieving inclusive growth.

The significant decline in social indicators in the CARs shows a need to adapt the MDGs by changing the base year to the year of worst poverty and social development. The creation of a regional poverty database using a standard methodology would facilitate the formulation of national poverty reduction programs and the monitoring of the status of the MDGs at both the national and regional levels.

In XUAR, illiteracy was below 2% among the young and middle aged in 2001. A system of compulsory elementary education is enforced, and the province has 21 institutions of higher learning with an enrollment of more than 100,000. In 2001, the province had 13,578 hospitals offering 35.1 hospital beds per 10,000 population as compared to 1.6 in 1949. A three-tier health system at the county, township, and village levels has been put in place, and the number of doctors and medical workers is above the national average. Almost half the population (8.1 million) now has access to piped drinking water.

Despite Mongolia's progress in meeting many of the MDGs, achievements in reducing income poverty have lagged behind. This is perhaps a combined result of

modest rates of economic growth and worsening income distribution. A more sustained effort is required to make growth more inclusive and less dependent on exogenous conditions. On the basis of the latest survey undertaken in 2002–2003, other non-income MDGs appear to be achievable. Mongolia has a unique reverse gender gap with higher levels of enrollment among females in post-elementary education.

A photograph showing a man and a woman sitting at a table. The man is on the left, wearing a grey and black patterned sweater and a traditional cap. The woman is on the right, wearing a black jacket and a patterned scarf, holding a small white bowl. They are both looking at each other. The table is covered with a red patterned cloth and has several pieces of bread and a glass bottle. The background is a large, ornate red and black patterned rug.

Strong family ties underpin Central Asia's rich and diverse culture.

# Governance

**All countries have strengthened their constitutions, created enabling primary legislation, established market-based taxation systems, and strengthened public accounts.**

**C**AREC countries are making considerable efforts to improve governance with proactive assistance from development partners. All countries have strengthened their constitutions, created enabling primary legislation, established market-based taxation systems, and strengthened public accounts.

In the CARs, transforming centrally planned, command-driven, and control-oriented systems of government into ones based on transparency, accountability, predictability, and participation has proved difficult. This transformation was complicated by two main factors: (i) the sudden withdrawal of skills and resources needed to sustain public services; and (ii) the persistence of traditional networks of power and patronage that have impeded good governance and the impartial rule of law.

Many notable issues remain unresolved.

- Civil services are large and relatively underpaid.
- Core government offices handle policy development and problem solving—the function of line ministries—rather than focusing on principal issues.
- Financial, legal, and capacity constraints mean true local self-government is the exception and local state government is the rule.
- Effective judicial enforcement is lacking although legislation and regulation need improvement as well.
- Corruption is pervasive although governments have recognized this and have taken initial steps.

While there has been some improvement, independent media; free and fair elections; freedom of speech, association, and movement; fair treatment without

discrimination according to gender, ethnicity, religion, or area of origin; and access to information are still weak. Nongovernment organizations (NGOs) and private media are nascent but growing, and they are increasingly analytical and effective in disseminating information.

Reforms are crucial in: (i) the judiciary and out-of-court arbitration; (ii) public financial management and audits of state agencies and state-owned enterprises; (iii) local government; (iv) core functions of central governments especially policy development and program monitoring and implementation; and (v) facilitating regional agreements on border trade and natural resource management. All are possible candidates for regional initiatives.



Good governance and strong institutions will provide a sound future for Central Asia's youth.



Central Asia has a dynamic, growing industrial base.



# Private Sector Development

All CAREC countries have adopted privatization and market-oriented reforms. These include liberalizing prices and trade, providing private firms with special tax privileges, simplifying commercial dispute resolution mechanisms, improving access to finance, and streamlining regulatory frameworks. Small-scale privatization of housing, trade, and services has been the main engine for increasing private sector participation. There has been relatively little progress on privatizing large state-owned enterprises. There has also been very little privatization in the agricultural sector. Insecurity of property rights and land tenure adversely affect agriculture investment and labor productivity.

Foreign direct investment and promotion of small- and medium-sized enterprises (SMEs) have been the most important modalities for private sector development. FDI has been promoted by giving foreign investors tax breaks and special guarantees that are generally negotiated on a case-by-case basis. Special tax breaks and direct financial assistance are also provided for SMEs. Many governments are developing microcredit schemes that encourage non-farm enterprises and urban self-employment. Steps are being taken to minimize corruption as it has a strong negative impact on private sector and SME development.

With these ongoing efforts, the private sector's share of GDP has increased dramatically.<sup>9</sup> However, most of this progress is connected with privatization rather than with private investment. Most significant private sector investments have been in extractive sectors regulated by concessional agreements with few if any links to the rest

**Most progress is connected with privatization rather than with private investment.**

**A unified market within Central Asia would be attractive to foreign and major domestic investors and would facilitate private sector development.**

of the economy. The near absence of foreign investor interest outside the natural resource sectors points to fundamental impediments to private sector development in Central Asia.

Some core issues facing the private sector are: (i) policy instability and corruption; (ii) excessive taxes and regulations resulting in high entry barriers and extensive rent-seeking by poorly paid officials; (iii) weak and inconsistent competition and privatization policies; (iv) a poor and in some countries corrupt judicial system accompanied by an incomplete body of commercial laws and poor enforcement of accounting and auditing standards; (v) an inability to access required finance due to weak commercial, legal, and banking systems; (vi) poor quality public infrastructure that raises transaction costs and discourages exports from the region; and (vii) weak or non-existent land ownership rights.

A unified market within Central Asia would be attractive to foreign and major domestic investors and would facilitate private sector development. A unified market would also eliminate the plethora of border controls, tax and financial regimes, and product standards that currently raise transaction costs. An efficient, seamless transport and transit system within the region would greatly facilitate the growth of private enterprise which is a necessary condition for sustained, diversified, and inclusive economic growth.



Women are an important part of the industrial labor force.

Central Asia's abundant water resources are a major shared asset. The region also has significant oil and gas reserves and mineral resources.



# Environmental Concerns

**A**part from the Aral Sea, there are several environmental issues that need attention and active, long-term cooperation among CAREC members. The most important are:

- weak government ownership of environmental programs in some countries because of institutional constraints and poor understanding of the severity of the problems;
- inadequate budgets for national programs and regional initiatives and organizations;
- poor integration among national environmental strategies and an inability to mainstream environmental issues in economic development;
- a lack of national monitoring, information management, and analytical capacities that constrains effective policy design.

There is also an emerging environmental threat to regional stability and peace. Increasing demands on water by riverine states, including Afghanistan, and the ongoing stalemate in resolving the region's water-energy nexus is beginning to cause tension and open discord.<sup>10</sup> The issue of river pollutants crossing international borders is also acquiring added significance. Because measures to achieve sound water management cannot be separated from international management of shared water resources in the Aral Sea Basin and in several smaller basins, ADB is continuing its efforts to facilitate regional dialogue and plans to remain engaged with key decision makers.

CAREC members and development partners have taken a number of steps to improve environmental and

**Increasing demands on water by riverine states, including Afghanistan, and the ongoing stalemate in resolving the region's water-energy nexus is beginning to cause tension and open discord**

natural resource management. International concern over the Aral Sea led to the launching of the first Aral Sea Basin Program under the banner of the Interstate Council for Saving the Aral Sea (later merged with the Interstate Fund for Saving the Aral Sea). The heads of state of five CARs constituted its executive committee and oversaw implementation. Principal funding for this initiative came from the Global Environment Facility (\$21.1 million) through the World Bank. Several other regional organizations have tried to address these problems. Of particular note is the Central Asian Economic Community's<sup>11</sup> successful brokering of the Interstate Agreement on Water and Energy Use in the Syr Darya signed in 1998 by Kazakhstan, Kyrgyz Republic and Uzbekistan and acceded to by Tajikistan in 1999.

ADB has provided considerable environmental technical assistance to the region, primarily through grant funds channeled through ADB by the Government of Finland.<sup>12</sup> While the majority of this assistance has been directed to strengthening the capacities of national environmental agencies, several regional activities have also been undertaken to encourage cooperation in addressing natural resource management problems. These have covered mountain area development, water management, and land degradation as well as the creation of a regional environmental action plan. ADB has also promoted cooperation by lending its support to several regional gatherings.

ADB is working to better understand important environmental and natural resource management constraints on national economic development and to mainstream attention to these issues into its programs and into the economic policies, plans, and programs of the CARs. Most future technical assistance would best be organized at either the national level or under flexible regional umbrella arrangements designed to facilitate national programs and responses.

# Donor Activity in the Central Asian Republics

**O**ver the past 10 years, the international community has actively supported initiatives for regional cooperation among the CARs. ADB, the World Bank, IMF, the European Union (EU), United Nations (UN) agencies, the European Bank for Reconstruction and Development (EBRD), the Islamic Development Bank, and the Aga Khan Foundation are the principal multilateral providers of grants and/or concessional financing. The United States, Switzerland, Germany, the United Kingdom, and Japan are the major bilateral development partners. Among the multilateral development partners, the EU, the United Nations Development Programme (UNDP), the United States Agency for International Development (USAID), and the World Bank have formulated and adopted a regional approach to designing and implementing their operations in Central Asia. UN agencies have also developed several programs to promote regional cooperation. Central Asia as a region has a larger number of and perhaps more activity by development partners than any other of ADB's operational regions. Donors have recognized the need for effective and sustained coordination and have agreed to join the CAREC program. In future, CAREC will also coordinate more closely with regional organizations such as SCO and CACO.

**ADB has actively collaborated and coordinated with both multilateral and bilateral donors on CAREC, and some joint initiatives have also been implemented outside the program.**

ADB has actively collaborated and coordinated with both multilateral and bilateral donors on CAREC, and some joint initiatives have also been implemented outside the program. Notable among them has been a regional initiative on Commonwealth of Independent States-7 countries<sup>13</sup> jointly with EBRD, IMF, and the World Bank. The objective of this initiative was to mobilize international policy attention and resources for their debt-laden economies and to intensify the policy dialogue between development partners and these countries. ADB has also been participating as an observer in the EU-IFI working group on Central Asian economies that meets annually to exchange information and ideas and to coordinate regional activities. ADB has collaborated actively with UNDP in the preparation of their regional perspective, the Silk Road initiative, and the Central Asia Human Development Report. All active multilateral and bilateral development partners have been consulted in the preparation of this RCSP.



Shuttle traders have stimulated cross-border trade and the development of vibrant markets in Central Asia.



# ADB'S Strategy for Regional Cooperation

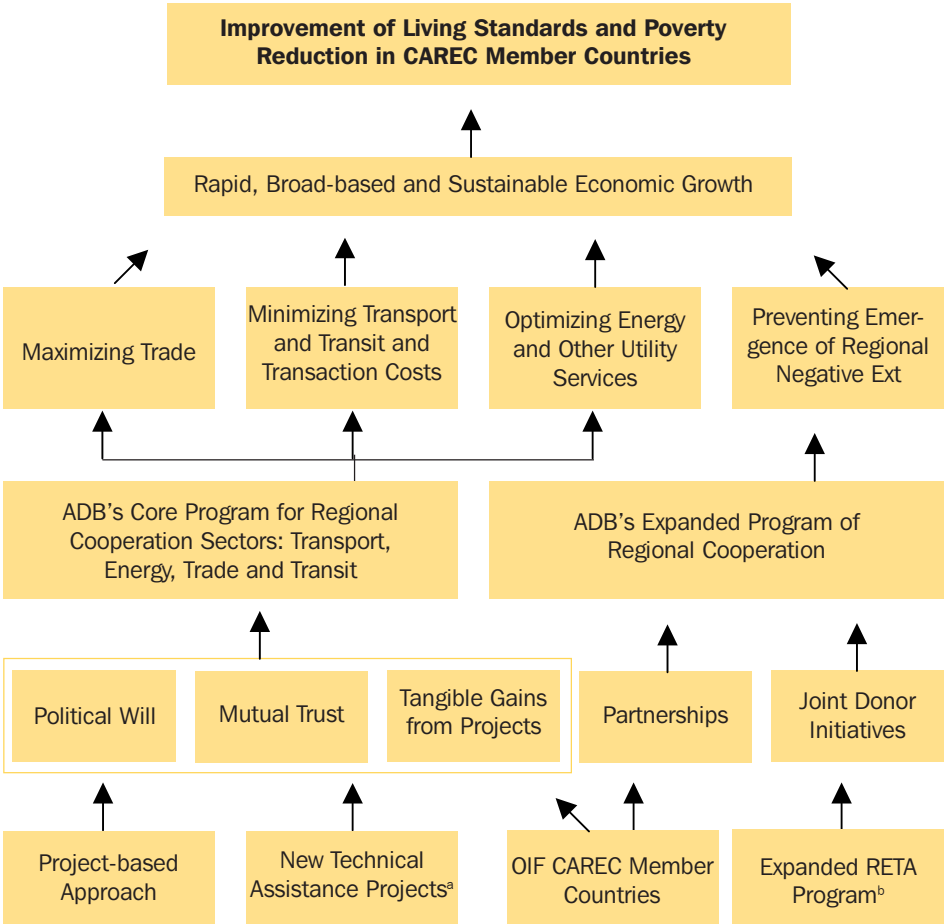
**T**he goal of regional economic cooperation is to improve welfare and to reduce poverty in member countries. The necessary condition for achieving this goal is rapid, broad-based, sustainable economic growth. The role of regional cooperation among CAREC members in this context can be best brought out in a strategic framework with four long-term objectives (Figure 2):

- securing access to profitable export markets;
- reducing transaction costs and facilitating transit and transport across the region;
- improving energy supplies to sustain growth;
- preventing negative regional outcomes.

The first objective is increasing trade and integration with large markets, both globally and in the greater region. The CARs have to secure access to markets in Russia, the PRC, South Asia, Iran, and Turkey to export natural resources, goods, and services. Regime change in Afghanistan and future participation by Turkmenistan will make the region a preferred route for possible north-south and east-west transport corridors. ADB is already supporting some cross-regional initiatives, and these have attracted strong interest both from the CARs and from South Asian countries. These include the Central and South Asia Transport and Trade Forum and the Turkmenistan-Afghanistan-Pakistan natural gas pipeline.

The second objective for regional cooperation is to reduce transaction costs and to facilitate transit. This will allow CAREC members to establish inter-regional corridors to use their location to their advantage and will restore their historical role as a land bridge between some

**Figure 2: Framework for Regional Cooperation in CAREC Member Countries**

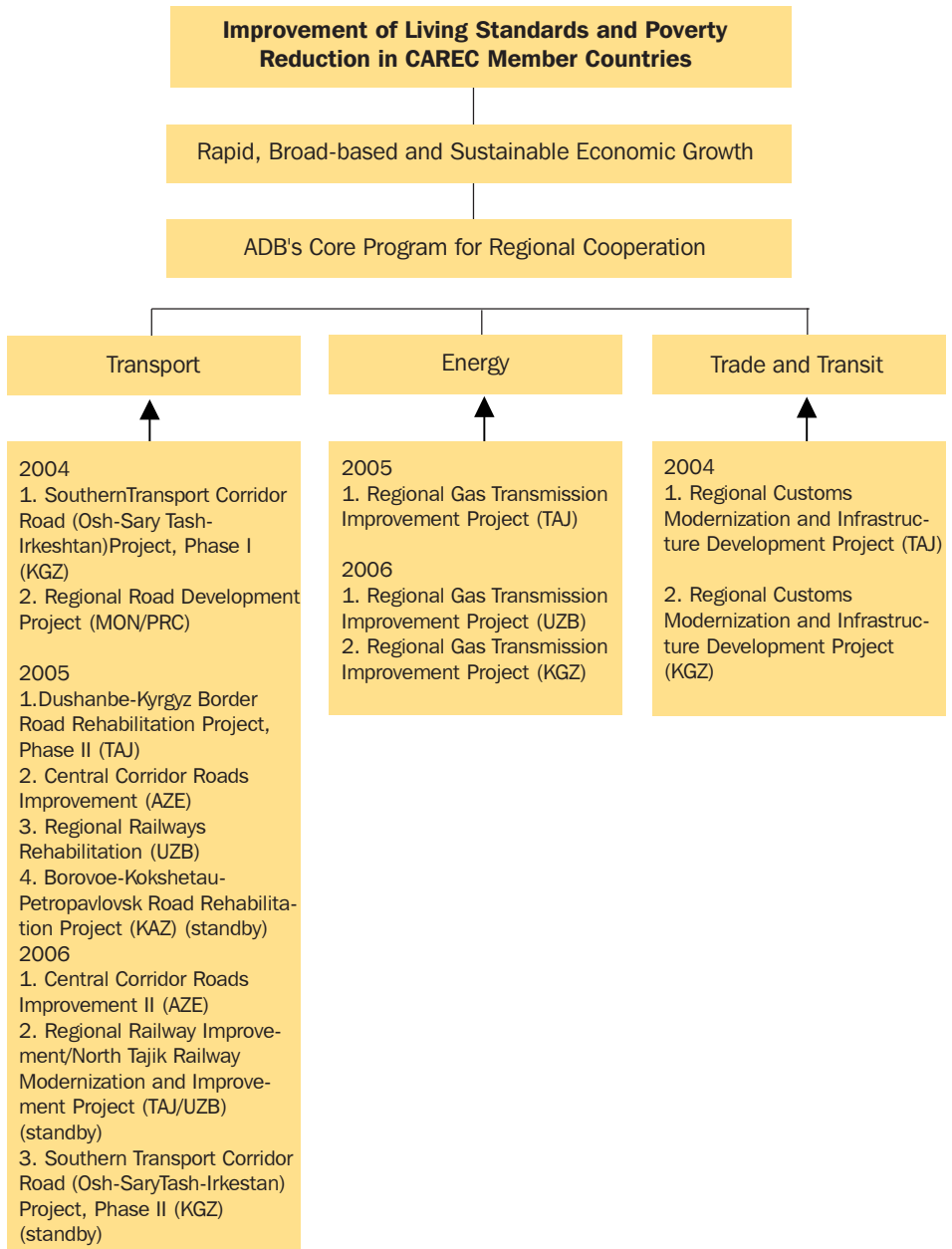


ADB = Asian Development Bank, CARs = Central Asia Regions, OIF = Overall Institutional Framework, RETA = regional technical assistance

a 1) Building Constituencies for Regional Cooperation, 2) Expanding Information Network, and 3) Quantifying gains from Regional Cooperation in Sectors.

b 1) Water Resource Management, 2) Environment Information System, 3) Land Reclamation, 4) Poverty Database, and 5) Communicable Diseases

**Figure 3: RCSP—Core Program for 2004–2006**



ADB = Asian Development Bank, CARs = Central Asia Regions, KAZ = Kazakhstan, KGZ = Kyrgyz, MON = Mongolia, PRC = People's Republic of China, RCSP = Regional Cooperation Strategy and Program, TAJ = Tajikistan, TKM = Turkmenistan, UZB = Uzbekistan

of the world's most dynamic, large, and emerging economies.

The third objective is to improve supplies of energy (both electricity and gas) not only to sustain growth but also to mitigate harsh climatic conditions. This requires rehabilitation and expansion of generating and transmitting facilities. Central Asia is an energy-surplus region; in the long term it could export significantly to Afghanistan, the PRC, South Asia, and even Eastern Europe via the Russian network. The fourth objective is to address environmental degradation, the spread of communicable diseases like tuberculosis and HIV/AIDS, and trafficking in humans and drugs.

The RCSP supports these four objectives while taking into account lessons learned, resource constraints, and the regional programs of other development partners. It comprises two components. The core program (Figure 3) continues the focus on transport; energy and trade facilitation; and projects with tangible, equitable, positive results. Maintaining adequate capacity in these sectors is essential for private sector SME growth that will generate employment and reduce poverty. Regional infrastructure developed during the Soviet period is in disrepair; rehabilitation and expansion are best undertaken regionally to attract foreign direct investment. Without regional infrastructure and streamlined regulatory frameworks for trade and transit, CAREC countries cannot expect to expand trade with larger neighboring economies. The RCSP also focuses on regional aspects of social sectors that support national efforts. Education and health are, however, at this stage more effectively addressed at the country level and are therefore covered in individual country strategies and programs.

The 2004 lending program will include four loans. A regional customs modernization and infrastructure development project (Kyrgyz Republic) has also been added. The regional road development project (PRC/Mongolia) included in Mongolia's country strategy and program update is also presented here. For 2005–2006 lending, a regional railway development project covering

Afghanistan, Tajikistan, and Uzbekistan has been added to reflect ADB's recent agreement with these governments. The regional gas transmission improvement project for Tajikistan has been moved to 2005, and for Uzbekistan and Kyrgyz Republic to 2006.

The second component is an expanded program of regional cooperation designed to forge partnerships with other development agencies to take advantage of emerging opportunities. Sectors in which other partners have taken the lead—but in which ADB has also been active—are the environment, water resource management (including rehabilitation of irrigation systems), and land management. As part of an expanded program and depending on future requirements, ADB could consider partnerships with other organizations for controlling drug trafficking, preventing desertification, and developing the private sector. Operations will depend upon the outcome of consultations with the parties involved. The expanded program will be supported by regional technical assistance included in the RCSP pipeline. In the context of designing and implementing larger regional projects, ADB and other development partners could follow up on recent suggestions from CACO for establishing regional consortia in specific sectors to develop capacity and mobilize investments. These consortia could be used to deliver larger regional projects that are likely to be concentrated in sectors such as transport, pipelines, energy, telecommunications, and the water-energy nexus.

Close cooperation between CAREC member governments and donor agencies is fundamental to Central Asia's economic development.



# Mobilizing Resources

## The Existing Portfolio

**T**o date, ADB has funded five investment projects amounting to \$224.1 million. Of this amount, \$122 million was funded through ordinary capital resources while \$102.1 million came from the Asian Development Fund. ADB also leveraged cofinancing amounting to \$135.2 million for two projects.

Since 2000, a total of \$8.7 million has been provided in 14 technical assistance grants in priority areas: \$3.1 million for regional power and gas transmission, \$3.0 million for trade facilitation and customs reform, and \$2.6 million for regional transport projects. In addition, a series of 7 regional technical assistance projects amounting to \$6.1 million, \$3.2 million of which is from the Japan Special Fund, has been used to implement the program including support for the OIF to hold conferences and meetings and to undertake other related activities.

## Overall Assistance for 2004–2006

The regional program for 2004–2006 comprises 14 loan projects amounting to \$295.3 million and \$18.5 million in non-loan technical assistance. It reflects both increased support and a certain degree of over-programming because there is more uncertainty involved in the regional program than in individual country counterparts. Efforts are under way to seek cofinancing for both types of assistance. Project preparatory technical assistance will account for 13.3% of the non-lending program. Regional technical assistance will increase to support expanded regional activities.

## Assistance for Strategic Priorities

The RCSP was endorsed by CAREC members at a special session of the OIF held in April 2004. It has been

**Policies and measures to improve regional energy trade will open new opportunities for the private sector to invest in exports outside the region.**

reviewed by all of ADB's key development partners and incorporates their views and comments. Regional cooperation between Mongolia and the PRC is in initial stages but is poised to expand.<sup>14</sup>

### **Energy Sector**

The medium-term strategy is based on maximizing the use of available regional infrastructure to support economic growth. To that end, ADB approved a loan to modernize the regional transmission networks in Tajikistan and Uzbekistan. Investments in new energy supply projects will be deferred for the time being. Policies and measures to improve regional energy trade will open new opportunities for the private sector to invest in exports outside the region. In the longer term, exploitation of new hydropower resources in the Kyrgyz Republic and Tajikistan—as well as natural gas reserves in Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan—will reduce the use of oil and coal and their potentially harmful environmental impacts.

Specifically the strategy will (i) develop a regional master plan; (ii) reinvigorate regional energy trading for domestic shortfalls; (iii) rehabilitate power substations, gas pipelines, gas treatment projects, and power generation projects; (iv) refurbish power projects to reduce emissions and to strengthen environmental sustainability; (v) upgrade capacities to improve quality, reliability, output, and efficiency; (vi) create third-party access to the existing network and increase the use of renewable energy where possible; and (vii) build skills and capability.

### **Transport Sector**

ADB has emerged as the leading supporter of regional transport projects in the CARs through eight loans worth \$317 million to Kazakhstan, the Kyrgyz Republic, and Tajikistan for the rehabilitation of roads and two loans of \$140 million to Uzbekistan for the rehabilitation of railways. ADB's regional strategy is to provide physical links to all parts of the region including isolated areas; to provide access to external markets; to integrate and



upgrade infrastructure; to enhance competitiveness; and to support policy and institutional reforms. ADB supports internal regional transit and external transport between Central Asia and the outside world.

Priorities are (i) developing east-west and north-south regional transport corridors using existing infrastructure to link state capitals, production centers, markets, and granaries to ports and to regional and international markets; (ii) improving the framework of international agreements to integrate regional operations and to enhance the quality of regional services; (iii) harmonizing the regulatory framework to remove legal obstacles and to promote efficiency; (iv) reducing delays and transport costs caused by customs, visas, and other requirements through capacity building; (v) setting tariffs and market values based on competition to more fully utilize regional transport capacity; and (vi) improving management effectiveness and streamlining financial procedures. Nine projects amounting to \$222.1 million are proposed to support these priorities.

### **Trade Facilitation**

Although total exports from the CARs increased from about \$4.2 billion in 1993 to about \$16.3 billion in 2002, intra-regional trade declined from 13.7% to 7.8% over the same period. This was due to a narrow export base, a lack of trade diversification, infrastructure bottlenecks, inefficient border and transit facilities, and weak institutional support. To address these constraints, ADB has provided technical assistance that promotes regional dialogue; builds capacity through training; and facilitates discussions on the regional transit system, data sharing, and document harmonization. ADB has also lent funds to the Kyrgyz Republic and to Tajikistan to help with the legal reform of customs, the first and most important step toward modernization and harmonization with international practice. ADB is helping both countries design master plans to develop supporting infrastructures for customs modernization.

**ADB supports internal regional transit and external transport between Central Asia and the outside world.**

**ADB will pursue a three-pronged strategy for further trade facilitation and customs modernization**

ADB will pursue a three-pronged strategy for further trade facilitation and customs modernization:

1. development of customs infrastructure (both software and hardware) through legal and procedural reforms, information and communication technology for automated customs services, border development, and provision of special equipment to prevent drug trafficking;
2. development of infrastructure (through various public-private partnership initiatives) to promote brokers' associations and other trade-related associations;
3. development of regional public goods through cooperative initiatives (e.g. harmonized customs legal frameworks and procedures, regional transit systems, and data sharing).

**Donor Coordination**

ADB will actively coordinate and cooperate with regional donors like the Islamic Development Bank, Kuwait, Saudi Arabia, and the Abu Dhabi Funds to maximize cofinancing. Donor coordination will be further strengthened around operations related to and emerging from the workings of the OIF and around joint economic and sector work in the expanded program. Extending the geographic scope of projects to neighboring countries, especially those that are not presently ADB members, will also strengthen coordination.

The strategic agenda presented in this RCSP implies a substantial increase in regional cooperation. The OIF will expand and strengthen its agenda and will require more intensive support from CARECU. Nearly all major development partners have adopted expanded regional programs and have established regional offices to implement them. ADB's enhanced presence in the region will help coordinate its activities with other development partners and will demonstrate ADB's commitment to the expanded CAREC program in the coming years.

# Risks

These include the following:

- lack of support for and ownership of the regional strategy by participating countries;
- unwillingness of development partners to accept the RSCP framework as a basis for cooperation and division of work;
- non-allocation of necessary staff and other resources by ADB;
- regional instability engendered by factors such as exacerbated interstate border tensions, ethnic conflicts, sharp declines in international commodity prices or religious extremism;
- sharper and growing policy divergence and consequent differentials in performance of participating countries;
- rapid moves towards bilateral or multilateral ties with outside partners that may mortally weaken attempts at regional cooperation among the CARs;
- non-participation of some regional countries in the program resulting in fewer benefits and more constraints on implementation.

These risks are considered significant and deserve concerted attention to minimize adverse impacts. ADB's proposed strategy is designed to mitigate some of the more important ones. Overall, they may be manageable because leaders in most CAREC countries increasingly recognize the importance of regional cooperation and are demonstrating more will to cooperate. ADB's regional cooperation efforts are endorsed at the highest levels. ADB will continue to closely coordinate its regional activities with all other partners and will continue to participate regularly in OIF activities.

Expansion of the geographical coverage of regional projects and cooperation of larger neighbors will help reduce the risk of bilateral ties between CARs and their

**Risks are considered significant and deserve concerted attention to minimize adverse impacts.**

larger neighbors developing at the expense of intra-regional economic cooperation. It will remain important for ADB to engage effectively with all existing CAREC members and also to involve countries such as Afghanistan and Turkmenistan whose participation will immediately benefit regional programs. Cooperation between the East and Central Asia and South Asia Regional Departments within ADB will be intensified to facilitate cooperation among the CARs and their neighbors.

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- 1 PRC's involvement in CAREC is geographically concentrated in but not limited to Xinjiang Autonomous Region.
  - 2 Double landlocked means that the country itself is landlocked and that none of its neighbors has direct access to the sea. The only other double landlocked country is Liechtenstein.
  - 3 Statistics for the CARs include Turkmenistan, an ADB member.
  - 4 The poverty numbers have been taken from individual country strategies and programs. Uzbekistan's poverty estimates are not strictly comparable as these refer to consumption poverty while others report poverty on the basis of expenditure surveys. Tajikistan's numbers are for the end of 2003.
  - 5 In Azerbaijan the Absheron-Guba region has a 58% poverty incidence while the national average is 49%. In southern Kazakhstan, 46.2% of the population is poor while the average across the country is 28.4%. For other details see Tan, Elizabeth S. 2003. Poverty in East and Central Asia. Manila: ADB, (mimeo).
  - 6 In the case of Turkmenistan this is attributed to changing cultural and social norms: preference is now given to home child-care. For the other CARs, many pre-school facilities closed because of constrained public finances.
  - 7 The rise in tuberculosis incidence across the CARs can be directly attributed to a rise in income poverty and associated adult malnutrition plus a fall in social hygiene and quarantine standards.
  - 8 The overall human development index according to the United Nations Development Programme is medium-level with values ranging from 0.655 for Tajikistan to 0.755 for Kazakhstan.
  - 9 For example, it ranges from approximately 65% of gross domestic product in Kazakhstan to 25% in Turkmenistan, 60% in the Kyrgyz Republic, 50% in Tajikistan, and 45% in Uzbekistan.
  - 10 The water-energy nexus refers to the system of barter among CARs inherited from Soviet times. Under this arrangement, upstream countries stored water in winter to release it in summer for irrigation in downstream countries. In return, the downstream countries supplied electricity for heating during the winter months to upstream countries.
  - 11 At that time it was called the Interstate Council for Kazakhstan, Kyrgyz Republic, Tajikistan and Uzbekistan, and it has subsequently evolved into the Central Asian Economic Community (CAEC).
  - 12 McCauley, Brian. 2002. Central Asia: Summary Assessment of ADB Environmental Assistance, Manila: ADB.
  - 13 It originally included Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan. Mongolia joined later.
  - 14 The program of regional cooperation between Mongolia and the PRC is also handled by ECRD. Its current stage does not warrant a full-fledged RCSP and hence it is presented here as an operational program of assistance.

# Appendix A: Economic and Social Indicators

**Table 1: Selected Central Asian Region Economic and Social Indicators <sup>a</sup>**

Item	Fiscal Year					
	1998	1999	2000	2001	2002	2003
<b>I. Economic Indicators</b>						
<b>A. Income and Growth</b>						
1. GDP per Capita (\$, current)	755.0	688.7	671.7	709.1	745.2	860
2. GDP Growth (% , in constant prices)	1.7	4.4	8.1	10.2	8.4	8.4
Agriculture	(1.7)	10.3	3.3	9.5	2.4	3.4
Industry	2.8	5.0	11.5	11.8	10.7	8.1
Services	2.6	1.7	7.8	10.3	6.8	2.5
<b>B. Saving and Investment (current and market prices) (% of GDP)</b>						
1. Gross Domestic Investment	17.9	18.6	17.8	23.5	25.9	27.6
2. Gross Domestic Savings	11.3	17.5	22.6	23.3	25.5	26.2
<b>C. Balance of Payments</b>						
1. Merchandise Trade Balance (% of GDP)	(1.3)	3.6	13.7	7.9	9.3	10
2. Current Account Balance (% of GDP)	(8.7)	(3.9)	2.3	(3.2)	(2.7)	(2.7)
3. Merchandise Export (\$) Growth (annual % change)	(18.2)	8.3	48.1	(0.1)	3.9	24.8
4. Merchandise Import (\$) Growth (annual % change)	(6.0)	(10.5)	14.6	18.4	(1.2)	24.9
<b>D. External Payments Indicators <sup>c</sup></b>						
1. Gross Official Reserves (including gold, \$ million)	3,824.3	4,227.1	4,407.7	4,995.4	5,484.2	7958.8
2. External Debt Service (% of GNI)	4.3	5.5	12.2	11.5	12.9	-
3. Total External Debt (% of GDP)	29.3	33.6	49.8	58.1	63.3	-
<b>II. Social Indicators</b>						
<b>A. Population Indicators</b>						
1. Population (million)	62.4	62.9	63.3	63.8	64.4	65.0
2. Annual Population Growth Rate (% change)	0.9	0.8	0.6	0.8	0.9	0.9
<b>B. Social Indicators</b>						
1. Total Fertility Rate (births per woman)	-	-	2.4	2.4	2.3	-
2. Infant Mortality Rate (per 1,000 live births)	-	-	71.5	70.3	-	-
3. Total Life Expectancy at Birth (years)	-	-	66.0	65.5	65.0	-
Female	-	-	69.9	69.4	69.0	-
Male	-	-	62.3	61.8	61.3	-
4. Total Adult Literacy Rate (% of people aged 15 and above) <sup>c</sup>	99.1	99.2	99.3	99.3	99.3	-
Female	98.7	98.8	98.9	99.0	99.1	-
Male	99.6	99.6	99.6	99.6	99.6	-

- = not available or missing data for one or two countries, hence average was not computed.

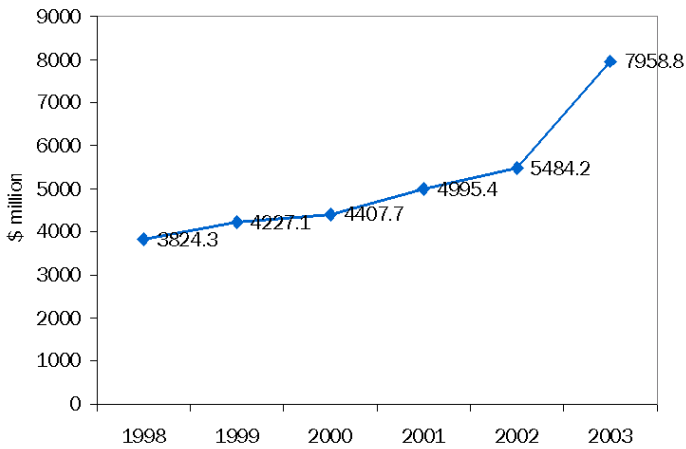
<sup>1</sup> Regional averages (or sums) were computed for Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

<sup>2</sup> Regional averages (or sums) exclude Turkmenistan.

<sup>3</sup> Average is computed only for 3 countries where data are available, namely, Kazakhstan, Tajikistan and Uzbekistan.

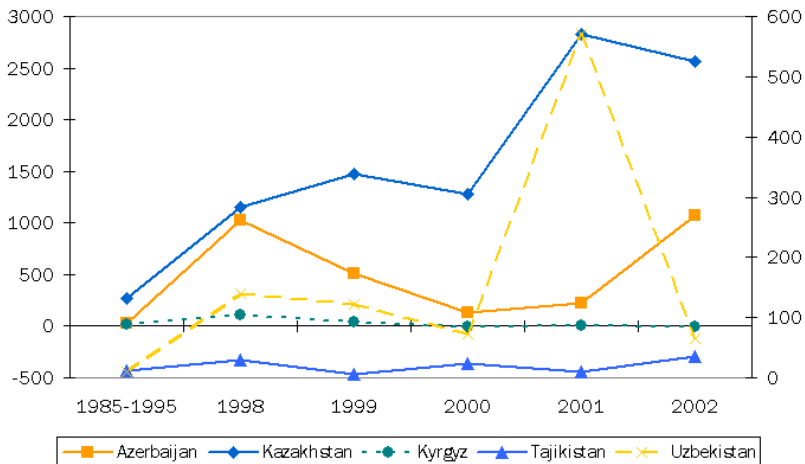
Sources: World Development Indicators Online, August 2004; Latest Respective Country Strategy and Program Updates

**Figure 4: Gross Official Reserves**  
(including gold, \$ million) 1998–2003



Source: World Development Indicators Online, August 2004.

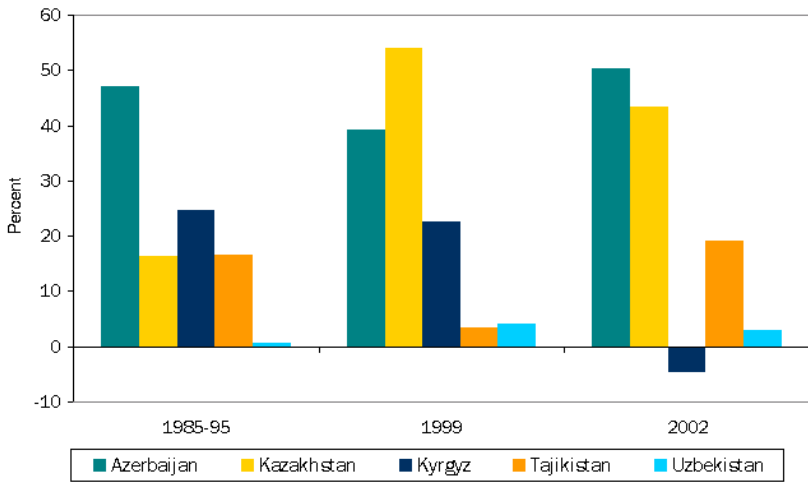
**Figure 5: Foreign Direct Investment Flows**  
(in \$ million) 1985–1995, 1998–2002



Source: World Investment Report 2003, UNCTAD

### Figure 6: Foreign Direct Investments

(as % of Gross Fixed Capital Formation, 1985–95, 1999, and 2002)



Source: World Investment Report 2003, UNCTAD.

## Appendix B: Regional Organizations

### 1. Economic Cooperation Organization (ECO)

- (i) Established in 1985 by Iran, Pakistan and Turkey, in 1992 it expanded to include 7 new members: Afghanistan, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- (ii) Its objective is to seek sustainable socioeconomic development of member states.
- (iii) ECO heads of states have met frequently since 1992, and the summits have typically included declarations and agreements. However, the implementation record has been poor and the impact has been limited. A fundamental obstacle to regional integration is the similarity of the member countries' economies which all tend to specialize in a small group of primary products such as oil, gas, minerals, and cotton. Trade among the Central Asian Republics (CARs) and with their neighbors has therefore expanded slowly.
- (iv) A recent priority is assistance in the reconstruction of Afghanistan. A 5-year action plan was endorsed in 2003.

### 2. Central Asia Cooperation Organization (CACO)

- (i) Established in February 2002, CACO includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan. It evolved from the Central Asia Economic Union formed in 1994 by Kazakhstan, the Kyrgyz Republic, and Uzbekistan. It became the Central Asian Economic Community (CAEC) in 1998 when Tajikistan joined and was re-named in 2002.
- (ii) CACO aims to expand cooperation in politics, economics, transport and energy infrastructure, water and energy resources, agriculture, trade, science, technology, environment, culture, tourism, sports, humanitarian issues, and regional safety and stability.
- (iii) In July 2003, the presidents of the 4 member states held a summit in Almaty. A number of agreements were signed, including closer coordination in combating terrorism and drug trafficking, as well as the creation of various consortia that will deal with such issues as water, energy resources, and food supplies.
- (iv) Central Asian leaders have attempted to distinguish CACO from its predecessor by emphasizing improved effectiveness. CAEC passed numerous resolutions but implementation was poor. Although there has been a flurry of activity since the establishment of CACO, it is



very early to judge whether implementation will actually improve.

- (v) In November 2003, President Nazarbayev of Kazakhstan, acting on behalf of CACO, wrote to IFI heads asking for their cooperation in establishing CACO consortia in sectors such as transport, energy, and water.

### 3. Shanghai Cooperation Organization (SCO)

- (i) In 1996, the "Shanghai Five" was established consisting of the PRC, Russia, Kazakhstan, the Kyrgyz Republic, and Tajikistan. In June 2001, Uzbekistan was invited to join and the group was officially renamed the Shanghai Cooperation Organization.
- (ii) The group aims to strengthen mutual trust among member states encouraging effective cooperation in politics, economy, science and technology, culture, education, energy, transportation, environmental protection, and other fields. It also hopes to jointly ensure regional peace, security, and stability.
- (iii) Two SCO permanent bodies-the secretariat in Beijing and the executive committee of a regional antiterrorism center in Tashkent-were set up in 2003.
- (iv) Despite the intention to cover the many issues above, SCO has focused on regional security and politics. It has also recently started focusing on economic matters.
- (v) An increasing level of interaction between CAREC and SCO is visualized in coming years.

### 4. Commonwealth of Independent States (CIS)

- (i) The CIS is a community of independent nations established by a treaty signed at Minsk, Belarus on 8 December 1991 by the heads of state of Russia, Belarus, and Ukraine. Between 8 December and 21 December, the three original signatories were joined by Armenia, Azerbaijan (its parliament, however, rejected ratifying membership until 1993), Kazakhstan, Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, and Uzbekistan. When Georgia joined in 1993, all of the former republics of the USSR except the Baltic states had become members of the CIS. Its headquarters are in Minsk.
- (ii) The organization was conceived as the successor to the Union Soviet Socialist Republics (USSR) in its role of coordinating foreign and economic policy of member nations. The treaty recognized current borders and each republic's independence, sovereignty, and equality. It also established a free-market rouble zone, embracing the

- republics' interdependent economies, and a joint defense force for participating republics.
- (iii) Strategic nuclear weapons in Belarus, Kazakhstan, Russia, and Ukraine were to be under the joint control of those republics with day-to-day authority in the hands of the Russian president and defense minister. Belarus, Kazakhstan, and Ukraine no longer possess such weapons.
  - (iv) At the CIS summit in 2003, four countries-Russia, Ukraine, Kazakhstan and Belarus-signed an agreement aimed at establishing a unified economic space with the ultimate goal of abolishing tariffs and harmonizing markets in key areas such as transport and energy. If realized, this plan would be the boldest initiative to come out of the CIS. Progress may be difficult to achieve given the track record of previous CIS resolutions and the conflicting interests of members.
5. Eurasian Economic Community (formerly the CIS Customs Union)
- (i) In December 1994, Kazakhstan announced the formation of a customs union treaty with Russia and Belarus that came into effect on 15 July 1995. The Kyrgyz Republic acceded in 1996 and Tajikistan in 1999 at which point it was called the Union of Five. In October 2000 the Union of Five was renamed the Eurasian Economic Community and a new treaty was signed in Astana that came into effect in May 2001.
  - (ii) The emphasis is on free intra-community trade as well as a common market for labor and capital, common policies towards migration, and more general policy harmonization. A specific intention is to coordinate WTO accession as underscored in the February 2004 summit in Almaty.
  - (iii) Recent initiatives also include the financing of power stations in Kazakhstan and Tajikistan as well as a plan for a unified energy grid embracing member states.
6. Special Programme for the Economies of Central Asia (SPECA)
- (i) SPECA was launched in 1998 with the support of two United Nations regional organizations-the Economic and Social Commission for Asia and the Pacific (ESCAP) and the Economic Commission for Europe (ECE)-as an alternative forum for regional cooperation. The presidents of Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan signed the Tashkent Declaration on 26 March 1998 creating SPECA, and in September 1998 Turkmenistan officially

indicated its intention to sign the Declaration and to participate in SPECA projects.

- (ii) The main purpose of SPECA is to support the Central Asian countries in strengthening their cooperation in order to stimulate economic development and to facilitate integration with the economies of Asia and Europe. Through consultation with the participating countries, five priority areas were identified, and working groups were set up as instruments to develop and implement the program in each priority.

#### 7. GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova) Group

- (i) It was founded as a political, economic, and strategic alliance designed to strengthen the independence and sovereignty of these former Soviet republics.
- (ii) It seeks to enhance regional economic cooperation through development of a Europe-Caucasus-Asia transport corridor. It has also become a forum for discussion on existing security problems, conflict resolution, and the elimination of other risks and threats.
- (iii) Cooperation among delegations of Azerbaijan, Georgia, Moldova and Ukraine started in 1996 in Vienna, Austria, where four states issued joint statements and proposed common initiatives.
- (iv) On October 10, 1997, the Presidents of Azerbaijan, Georgia, Moldova, and Ukraine met in Strasbourg during the summit of the Council of Europe and stated their mutual interest in developing bilateral and regional cooperation, European and regional security, and political and economic contacts.
- (v) On April 24, 1999, Uzbekistan joined the group at the GUUAM Summit in Washington, D.C.
- (vi) During its 6-year existence, GUUAM has pledged to become a vital part of the east-west export routes although little effort has been made to achieve this goal. At the 2003 Summit, however, US commitment was obtained for projects relating to the creation of the Europe-Caucasus-Asia transport corridor.

#### 8. Black Sea Economic Cooperation

- (i) In June 1992, the heads of state and government of eleven countries—Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey, and Ukraine—met on the invitation of the Government of Turkey in Istanbul. This Summit was successfully

crowned with the signing of the historic Summit Declaration on Black Sea Economic Cooperation.

- (ii) Its objective is to create an area of free movement of people, capital, and goods in which initiatives for cooperation come from below rather than above, allowing roles for states in arranging the legal framework.