July 1998

ECONOMIC DEVELOPMENTS DURING THE 1990s AND PROSPECTS FOR THE FUTURE

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Paper prepared for the Central Asia 2010 conference sponsored by the United Nations Development Programme to be held in Almaty, Kazakhstan, on 20-22 July 1998.

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The Central Asian republics experienced significant short-term economic disruption during the early 1990s. The five countries were unprepared for independence, and were forced to concentrate during the early years of nationhood on institution building and addressing the immediate macroeconomic problems. By 1998 they were in a position to take a longer term perspective. This paper analyses the choices of development strategies and likely consequences for economic growth and development during the first decade of the next century.

The first section reviews the position of the Central Asian republics in the Soviet economic system. The dissolution of the USSR was followed by the rapid unravelling of this system, which was associated with output decline and hyperinflation in all former Soviet republics. Transition from central planning to a more market-oriented economic system was the only option, although the patterns of transition varied and in the first phase were overshadowed by the need to deal with economic hardship and hyperinflation. Section 2 describes the various national approaches to these problems of the first phase of national policymaking. The third section turns to the second phase and the achievement of longer term socioeconomic goals, and analyses the relationships between economic reform, development strategies and such goals. Besides the widely accepted elements of liberalization, openness and good governance, the alleviation of poverty is a contributor to economic growth, as well as being a desirable goal in itself; a favourable resource endowment is helpful, but less important than the elements just listed. The final section draws some conclusions about the future prospects for the five countries over the next dozen years.

1. The Starting Point

The highly centralized Soviet system brought benefits and costs to the Central Asian republics. Economic modernization was associated with improved living standards and other socioeconomic indicators such as longevity, health and educational attainment. The costs were externally imposed patterns of specialization, with extreme environmental degradation and erosion of some traditional social relationships.

Within the Soviet division of labour the Central Asian republics were all primarily producers of raw materials. The main crop was cotton, of which Uzbekistan is the world's fourth-largest producer. The Soviet heritage is criticized by nationalists for having reduced self-sufficiency by taking land out of food crop production, although the virgin lands program undertaken in the late 1950s and early 1960s to turn northern Kazakhstan into a grain-producing area has had mixed blessings because harvests have been volatile in the harsh climate. Turkmenistan, while also an important cotton producer, became dominated economically by natural gas production in the 1980s. In general, however, the Soviet planners were criticized for starving Central Asia's energy and mineral sector of capital for exploration and exploitation, and Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan and the Kyrgyz Republic are all trying to develop their energy and mineral resources in conjunction with foreign investors.

The only major exception to the primary sector bias is Tashkent, where a modern industrial sector was established during the 1941-5 war when factories were moved from vulnerable locations in the western USSR. Tashkent became the fourth largest city in the USSR and included high-tech industries such as aircraft production. Processing facilities were built near the natural resources, especially in Kazakhstan, but these "company towns" have been hard-hit by the disorganization of the 1990s, victims of Soviet planners' predilection for size and concentration. Other industrial projects were undertaken to promote development in poor regions, but these had weak economic foundations and many became white elephants after 1991 when supply and market links broke down.[1]

A striking feature of Soviet economic development was the disregard for environmental consequences. The Central Asian cotton economy is based on an irrigation system which drastically shrank the Aral Sea between the early 1960s and the 1980s, causing a major environmental disaster as mortality and morbidity rates in the worst affected areas (such as the Karakalpak autonomous republic in Uzbekistan) increased. The Aral Sea disaster clearly indicates that the past development strategy based on water- and fertilizer-intensive cotton cultivation is unsustainable. Kazakhstan contained the main nuclear testing areas in the USSR, and soil contamination is widespread. Apart from these specific environmental problems, Soviet Central Asia suffered from the general negative environmental consequences of a system which emphasised output and placed no cost on pollution, with high levels of urban pollution surrounding many mining areas or in cities with unfortunate wind patterns or other locational disadvantages.

The USSR also brought benefits to the people of Central Asia. Compared to their cousins in neighbouring countries they were often enjoying higher incomes and universally better access to health, education and other social services. Life expectancy at birth was over 65 years (Table 1) and literacy rates almost a hundred percent. Income inequality was moderate and absolute poverty rare, although together with Azerbaijan, the Kyrgyz, Tajik, Turkmen and Uzbek republics had the highest proportion of families below the Soviet poverty line (Atkinson and Micklewright, 1992, Table U13). Although the reality did not always match the Soviet rhetoric of equality, the economic status of women was hugely increased by access to education, health services and jobs outside the home.[2]

2. The First Phase: Policies and Performance 1992-7

The rapid unravelling of the Soviet Union brought problems of disorganization on top of the curtailment of many of the benefits, and these shocks were crucial determinants of policymaking in the half decade after 1991. Within the context of state and institution building the newly independent nations may have preferred to delay addressing economic transition, but within a common currency area they had no alternative to following Russia's January 1992 price reform. More generally, the challenge facing the governments of the newly independent Central Asian republics was how to manage the transition to a market economy in a society grown accustomed to the satisfaction of basic needs by the state.

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[1] A sugar refinery, accounting for 3% of the Kyrgyz Republic's GDP, was designed to refine cane sugar from Cuba for the Soviet market; without subsidized transport it made no economic sense. The aluminium smelter in the South Tajik Territorial Production Complex, the largest greenfield industrial complex in Central Asia, originally relied on bauxite from Guinea; it now runs at a loss and faces closure (Havrylyshyn and Al-Atrash, 1998, 17).

[2] Kaser and Mehrotra (1996, 221) quote a Soviet report that in 1925 in the whole of Turkmenistan only 25 women were literate. The numbers would have been higher elsewhere in Central Asia, but female literacy rates among the non-Slavic population were dismally low throughout the region. Trends towards greater gender equality in the workplace in the 1960s and 1970s are confused by the lack of ethnic disaggregation; some observers (eg. Lewis, 1992, 272-3) argue that the trends reflect the large number of Russian women moving into the region, while the status of the indigenous female population remained unchanged.

During the Soviet era the Central Asian republics benefited from direct transfers aimed at reducing the large differences in Soviet republics' fiscal revenues, and perhaps from indirect transfers resulting from intra-USSR trade at distorted prices. The direct transfers were substantial, although the magnitudes are difficult to estimate, mainly because many economic transactions were within Union-wide state enterprises which did not distinguish the location of revenues and expenditures (Pomfret, 1995, 48-50). Estimates of the indirect transfers vary (Orlowski, 1992, 1993; Tarr, 1994), with three of the countries losing from a shift to world prices and Turkmenistan and (possibly) Kazakhstan gaining from moving to world prices. After 1991 the transfers were partially retained within the ruble zone but at much reduced levels, and had finished by the end of 1993. In addition to the loss of transfers, the tight economic links imposed by Soviet planners led to serious trade disruption when the Union collapsed and payments mechanisms became uncertain. Thus, even Turkmenistan as a large potential gainer from moving to world prices, found that it had no alternative to exporting its natural gas along existing pipelines even though the importers were not paying.[3]

The loss of transfers and post-Soviet trade disruption came on top of the ubiquitous output losses following the shift from central planning to a more market-oriented economy.[4] Although the Central Asian republics were not committed to rapid economic reform, they were forced into major price shocks in 1992. In the USSR some jurisdictions had experimented with economic reforms during the Gorbachev era, but these did not include the Central Asian republics. Immediately after independence, however, the newly independent countries were constrained to follow Russia's January 1992 price reform; otherwise, with a common currency, they would have faced huge trade imbalances due to commodity arbitrage. Some differentiation was apparent as all five countries limited price increases of basic consumer goods, with Tajikistan, Turkmenistan and Uzbekistan employing the most price controls and Kazakhstan and the Kyrgyz Republic the least (Pomfret, 1995, 53-6).

During the first two years after the dissolution of the USSR, policy debates were dominated by the currency issue. Continuing use of the ruble simplified trade relations with other Soviet successor states and allowed continuation of indirect subsides through access to low Russian prices for oil, grain and other primary products. Nevertheless, the situation was untenable as the ruble zone was inherently hyperinflationary. The Kyrgyz Republic introduced an independent currency in May 1993 in order to regain macroeconomic stability. When Russia tried to assert sole control over monetary policy, its terms were unacceptable to other ruble users and Turkmenistan, Uzbekistan and Kazakhstan exited the ruble zone in November 1993. By the end of 1993 Tajikistan was the only country still using the old Soviet rubles, and the Tajik national currency was not introduced until May 1995.

There is a clear hierarchy in reducing hyperinflation (Table 2c). The Kyrgyz Republic had brought inflation down below 50% per annum by 1995. Kazakhstan reached this level in 1996. Uzbekistan had lower inflation peaks in 1992 and 1993 because more prices were controlled, but it was slower at bringing inflation down below 50%, which was only achieved in 1997. Turkmenistan

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[3] Among other major exports, Uzbekistan's cotton went primarily to textile mills around Ivanova in Russia and Kazakhstan's coal went to iron plants in the Ural and Siberian regions of Russia. Kazakhstan's oil refineries were served by pipelines from Siberia, and Kazakhstan's own abundant oil being developed in the west of the country has to be channelled by pipelines through Russia.

[4] De Broeck and Kostial (1998) explain much of the 1990-6 output loss in Kazakhstan in terms of disorganization brought on by disruption of supplier links and credit constraints.

and Tajikistan were slowest in addressing hyperinflation, with the former relying on price controls and the latter being hampered by political disruption.

A similar ranking applies to the speed at which the five countries have implemented economic reforms. In the Kyrgyz Republic state orders were eliminated in 1993 and practically all prices liberalized by 1994. Enterprise reform has been less dramatic than in Central Europe, Eastern Europe or Russia, but more extensive than in any other Central Asian transition economy. The financial sector has also been transformed, so that both the exchange rate and interest rates are market-determined, although thin markets have limited allocative efficiency.

In the two largest countries, Kazakhstan has generally been considered the more committed reformer. After independence, Kazakhstan moved faster than Uzbekistan in price and enterprise reform, and outside observers were optimistic about the resource-rich country's economic prospects. In the second half of the 1990s, however, concern has been raised over the failure of the government to establish a suitable institutional framework for a well-functioning market economy. Agents of the government are frequently seen to be benefiting from their position rather than enforcing law and order and maintaining public services for the public. Privatization largely benefited insiders, and exacerbated wealth differentials without obvious efficiency gains.

Uzbekistan has followed an explicitly gradual approach to economic transition. Price and enterprise reform both proceeded more slowly than in the other two countries. The cumulative effect, however, has been substantial as practically all prices had been liberalized by 1996, and housing and small enterprises had been privatized. Trade policy is liberal as export taxes imposed in the early 1990s have been removed, but there was a retrogression in the second half of 1996 when stringent exchange controls were reintroduced.

In Turkmenistan economic reform was minimal during the first four years following the dissolution of the USSR. The government sought to cement popular support by using the resource rents from Turkmenistan's abundant natural resources to provide free services and subsidized staple products, while avoiding major systemic change. Enterprise reform proceeded slowly with the government retaining a majority shareholding in many cases, urban housing privatization was suspended, and the June 1995 agrarian reform replacing state farms and cooperatives by peasant associations provided little incentive to producers whose major products had to be sold at official prices. The IMF described the situation in early 1996 as one of "limited progress" in reform and where "a heavily subsidized public enterprise sector continued to dominate the economy" (IMF *Country Report 96/30*, April 1996).

In Tajikistan independence was followed by civil war, which was only ended by the June 1997 peace agreement. Under these conditions, coherent economic policymaking was impossible and reforms were delayed. Housing privatization had been completed by the end of 1992, but enterprise privatization and land reform have been repeatedly interrupted by political changes. Price liberalization was essentially completed by March 1996, and the last steps in dismantling the state order system were the ending of state orders for cotton with the 1996 crop and abolition of the state marketing monopoly in 1997. By late 1997 the trade and foreign exchange regime was "generally liberal, notwithstanding reversals in trade reforms in late 1996 and early 1997" (IMF *Country Report 98/16*, February 1998). Progress in macroeconomic stabilization during most of 1996 was undone by the renewal of fighting late in the year, which was financed by an inflationary increase in the budget deficit which was in turn addressed by a reversion to direct controls. In July 1997 a renewed effort at economic reform was led by re-establishment of macroeconomic stability and a new effort to accelerate structural reforms. Due to this intermittent progress, it is difficult to compare Tajikistan's reforms with the other Central Asian countries; the intent seems to be more committed to rapid reform than Uzbekistan's, but progress has been less.

Perceptions of willingness to introduce radical economic reform have influenced access to external finance. All five countries agreed on the zero option, by which Russia assumed the external assets and liabilities of the USSR, so that they did not have hard currency debts. They had complex ruble-denominated debts with Russia and other former Soviet republics, mainly in the form of inter-enterprise arrears, but had difficulty negotiating other external credit. The international financial institutions were the main potential lenders, and the World Bank and IMF extended credit to the Kyrgyz Republic as early as 1993. Kazakhstan was also able to gain access to World Bank and IMF loans, whereas Uzbekistan was less generously treated and Turkmenistan and Tajikistan were practically ignored (Table 3).[5]

Access to external finance helped to make the favoured macroeconomic policies successful. The Kyrgyz Republic was actually the least successful in controlling its fiscal deficit (Table 4a), but IMF and World Bank funds enabled the Kyrgyz government to finance its deficit without excessive money creation. Kazakhstan and Uzbekistan had roughly comparable records in achieving fiscal control, but this translated into a superior inflation record in externally-assisted Kazakhstan. In sum, all three countries had achieved macroeconomic control by 1997, although this is more firmly based in Uzbekistan and Kazakhstan, which have almost achieved fiscal balance, than in the Kyrgyz Republic which achieved the lowest inflation rate but with the greatest external assistance.

The low open unemployment reported in the Central Asian republics is economically meaningless.[6] The incentives to register as unemployed are insubstantial, and appear to be more than offset by the stigma associated with the status of being unemployed. Many workers prefer to remain on the books of enterprises which are unable to sell what they produce or to pay their employees. Other, primarily female, workers have left the labour market and returned to a traditional role of unremunerated work in the household or to subsistence production. The ability to become more self-sufficient is widely thought to have made the economic impact of the abolition of central planning and the dissolution of the USSR less severe for poor people in rural areas than for poor people in the larger towns without rural relatives.

The informal economy has grown throughout Central Asia from a tiny base. Within the cities the presence of small traders is more widespread in Kazakhstan or the Kyrgyz Republic than in more regulated Uzbekistan or Turkmenistan. Informal cross-border trade with China or "shoppers' trips" to Southeast Asia, the Gulf or South Asia are also common from Almaty.[7] In the Kyrgyz Republic the greatest unregulated output expansion has been the reestablishment of opium poppy

[5] By 1996 the Kyrgyz Republic and Tajikistan had the highest debt/GDP ratios of any former Soviet republic. Much of their dept was on concessional terms (in Tajikistan's case from Russia as well as the multilateral institutions), while the other three CARs' smaller debt, relative to GDP, was largely on commercial terms (Kapur and van der Mensbrugghe, 1997).

[6] Survey data reveals higher incidence of unemployment, eg. 20% in the 1996 Kyrgyz LSMS, although it is difficult to say whether this is due to the method or to the more rapid Kyrgyz reforms. The depth of the decline in employment is better reflected in the number of registered employed, which fell in Kazakstan from 6.5 million in 1990 to 4.3 million at the end of 1995, when registered unemployment was reported at 4% (Bauer et al., 1997, 3), and 2.6 million in February 1998 (*Kazakstan Economic Trends*, January-March 1998, 102).

[7] Bauer et al. (1997, 35-42) report on a small survey of women as small-scale entrepreneurs in Kazakhstan.

fields and the extensive cultivation of marijuana.[8]

Measuring real GDP in economies where prices and the composition of output have changed enormously is difficult, but the relative performance of the Soviet successor states is generally agreed upon. Table 2a summarizes the IMF's estimates, which do not differ greatly from estimates provided by other international agencies. Uzbekistan has been the most successful former Soviet republic in limiting the cumulative output loss in the 1990s. Political stability and gradual economic reform help to explain this performance, but competent economic management has distinguished Uzbekistan from other gradual reformers such as Ukraine, Belarus and Turkmenistan. Uzbekistan was also fortunate in that world cotton prices were buoyant in the first half of the 1990s, and that it was not tied to existing pipelines in getting its main export to market.[9] Turkmenistan was also relatively successful in restraining the output decline during the early 1990s, but the failure of the non-gas economy since 1992 can be blamed on the lack of incentives for development of other sectors. Kazakhstan and the Kyrgyz Republic have both suffered much larger output drops since independence, as has Tajikistan, although this is clearly related to the civil war and political instability.

The relationship between policy and performance is apparent in the time path of Kazakhstan's GDP decline. In 1992-3 Kazakhstan sought to restrain the output loss by maintaining pre-existing links and structures, but after introduction of the national currency and the more purposeful pursuit of economic reform the largest annual drop in output occurred in 1994 - the year when both strategy and performance departed most markedly from Uzbekistan's - before the decline decelerated in 1995 and reversed in 1997. The Kyrgyz Republic appears to have followed a similar U-shaped performance path, advanced by between six months and a year.[10] The limited evidence on income equality and poverty suggests that the more rapid transition in the Kyrgyz Republic and in Kazakhstan has been associated with widening inequality and increased poverty to a greater extent than the more gradual transition in Uzbekistan and Turkmenistan.

3. The Second Phase: Socioeconomic Development 1998-2010

Before 1992 development strategies were determined in Moscow. Apart from establishing specific places in the Soviet division of labour, the policies of the USSR also left legacies of human and physical capital which need to be considered along with resource endowment and policies in order to assess future economic prospects. Kazakhstan, for example, inherited larger endowments of

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[8] Before 1917 the Kyrgyz Republic accounted for a fifth of world opium output. In the mid-1990s the UN Drug Control Programme estimated that four-fifths of the heroin consumed in Europe came from Central Asia (Kaser and Mehrotra, 1996, 248).

[9] Cotton prices have, however, declined continuously since January 1996, falling by 17% in 1996 and 7% in 1997 (*Uzbekistan Economic Trends*, January-March 1998, 18). Uzbekistan's second most important primary export is gold, which was even more readily exportable to world markets, although recent gold price trends have not been favourable. By contrast, Kazakhstan's Tengiz oilfield, which attracted the largest foreign investment contract in the former USSR at the start of the 1990s, is operating far below expectations due to difficulties with access to the Russian pipeline network. Turkmenistan quickly found that it could get its natural gas to Georgia and Ukraine, but had no credible response to delayed payment, when the pipeline routes precluded any diversification of destinations.

[10] Kazakhstan's real GDP fell by 8.2% in 1995 and then grew by 0.5% in 1996 and 2.0% in 1997 (*Kazakstan Economic Trends*, January-March 1998, 92). Real GDP in the Kyrgyz Republic fell by 5% in 1995 and increased by 6% in 1996 (*IMF Staff Country Report 98/8*, January 1998, 4).

trained personnel than its southern neighbours, although it has also experienced large emigration of skilled labour in the 1990s. The first phase of national economic policymaking, while addressed primarily to immediate stabilization matters has also contributed to the diversity of starting points for the second phase, with increased poverty being especially important in the already poor Kyrgyz Republic and Tajikistan. After first examining the links between stabilization and transition strategies and growth prospects, this section will then analyse national development strategies.

One of the big, and incompletely resolved, debates in the transition literature concerns the relationship between the speed of reform and the prospects for long-term economic growth. The conventional wisdom, associated particularly with the World Bank and IMF, is that a more reformed economy provides a better springboard for future growth (World Bank, 1996). This appears to be supported by the recent performance of East European rapid reformers, eg. Poland and the Czech Republic, but it fails to explain China's impressive sustained growth over two decades since economic reforms were initiated, even though the reform process in China has in key respects (eg. enterprise reform and financial reform) been slow and remains incomplete. A common feature of both Polish and Chinese growth has been the emergence of new small and medium-sized enterprises, suggesting that the critical issue is not just speed of reform, but whether the reform process encourages or discourages new enterprises.

Transition from central planning has everywhere been associated with increased income inequality, and rapid reform has accentuated such differentiation (Milanovic, 1998). This is especially a problem in already poor countries, where increases in the number and depth of poverty raise policy dilemmas, which may have a negative impact on growth, if the government feels it desirable to channel resources from growth-inducing investment in human and physical capital to consumption goods for starving people.[11] Similarly, poor individuals may be forced to liquidate their assets, eg. cutting down fruit trees or killing livestock for current consumption (as reported by Howell (1996) for southern farmers in the Kyrgyz Republic), or to reduce support for their children's education.

The southern republics were open economies closely integrated into the Soviet economy, and to a lesser extent linked to other members of the Council for Mutual Economic Assistance, but isolated from the rest of the world. After independence they all tried to diversify their trading partners, although the process was hampered by transport and communications networks oriented to the north. Only by 1996 did the share of trade going outside the former Soviet Union exceed half (UNECE, 1997).

The national development strategies have been outward-oriented,[12] even if exports (and inward foreign investment) have grown slower than hoped. Such an orientation aims to benefit from the pre-existing specializations in primary products, and to open up foreign markets for old and new

[11] The ability to maintain government expenditure is also important. Table 4(b) indicates that already in the early post-independence years the sharp decline in government expenditure relative to GDP in Kazakhstan led to a big drop in expenditure on education and health, while Uzbekistan's success in maintaining government expenditure was accompanied by an increase in the share going to education and health.

[12] It is difficult to quantify the degree of openness. Havrylyshyn and Al-Atrash (1998) conclude that the Kyrgyz Republic and Uzbekistan are significantly more closed and Kazakhstan more open than other economies at similar level of development, but this is based on trade/GDP ratios using purchasing power parity GDP. Using GDP at market prices, Kazakhstan is more closed than the other two. Market prices are distorted, but so are PPP estimates; it is impossible to say which is the appropriate measure.

industrial products. There have been measures to protect domestic industries, although trade policies have generally been liberal with low formal trade barriers. There has also been an attempt in Uzbekistan to diversify agricultural output away from the cotton monoculture by planting a greater area with food crops, which can be justified as a move towards self-sufficiency, although a more powerful argument is that the cotton monoculture was unsustainable on environmental grounds. Such initial tendencies towards trade-reducing measures, which also included widespread use of export taxes in the early 1990s, have largely been repudiated by 1998 and do not seem part of long-term national development strategies. Given the overwhelming evidence of a positive relationship between openness and growth, an outward-oriented strategy is surely appropriate.

In what sectors can growth be expected, and how should government policy promote such growth? That is the topic for the opening day's papers in this conference. A critical issue as mentioned above, is how to encourage small and medium-sized enterprises; the international evidence is that the most important factor is not to make new enterprise formation an obstacle course through red tape and other set-up costs. The main positive role for policy is to reform the financial sector such that it encourages saving and channels funds to the socially most desirable uses rather than to large established customers. Financial reform has lagged in the Central Asian republics, insofar as the old monobank system has been dismantled but not replaced by appropriately regulated entrepreneurial financial institutions; the Kyrgyz Republic has progressed furthest, Kazakhstan has deregulated banks without satisfactory supervision,[13] and the other countries have maintained fairly strict controls over financial institutions.

A hands-off approach has been successful in agrarian reform in China and Vietnam, but is less universally appropriate to Central Asian agriculture where there are economies of scale in the main crops. Cotton, in particular, requires maintenance of an irrigation network in which the government cannot avoid being involved. Governments must also provide the infrastructure (property rights as well as pipelines) for successful exploitation of oil, gas, hydroelectricity and minerals. In both the management of water resources and the provision of the means for efficient export of energy, cooperation between the governments of Central Asia will be essential as rivers and pipelines cross boundaries and require firm guarantees of long-term access.

Resource endowments differ among the Central Asian countries. Uzbekistan has benefited in the first half of the 1990s from buoyant prices for its relatively easily exportable cotton and gold. Kazakhstan and Turkmenistan have the most favourable resource endowments for the long-term, with their oil, gas and mineral resources. Exploitation has been hampered by existing infrastructure, but improved pipelines could lead to substantial export earnings. The economic policy dimension will be how to avoid Dutch disease consequences of success in exporting resource-intensive products, ie. an appreciating currency that makes other exports uncompetitive and leads to destruction of long-term-viable activities by competing imports so that when the oil or gas runs out the country suffers a hard landing.[14]

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[13] In Kazakhstan during the hyperinflationary years financial sector deregulation led to proliferation of banks, many of which were simply conduits for obtaining funds from the central bank at negative real interest rates. After a restructuring programme was initiated, the number of banks in Kazakhstan dropped from 183 at the start of 1995 to 131 by the end of 1995 and to 76 by 1st March 1998. The central bank has been active in temporarily administering delinquent banks and revoking licences, but it is not yet clear whether an entrepreneurial banking sector has been created.

[14] Rosenberg and Saavalainen (1998) argue that adverse effects of an oil boom will be moderated for Azerbaijan and Kazakhstan by the initial undervaluation of their currencies and by the need to restructure the

It is also worth emphasising that resource endowments are not the panacea for economic development. There are many examples of oil-exporting nations who have suffered economic decline, and of resource-poor countries which have become economic success stories.[15] There may even be causal links as resource abundance leads to competition for the rents, while true entrepreneurship and good governance languish, and resource scarcity forces countries to try harder to achieve economic success.

The increase in poverty and the widening income gaps will be addressed in the second day's panels. It is essential to understand the nature of poverty in Central Asia in order to design social safety nets to protect the most vulnerable. Universal entitlements will be too expensive and wasteful of scarce resources. Several innovative responses have emerged, such as the mahalla programme in Uzbekistan, and it is likely that the best solution will be a heterodox package of measures whose specifics vary from country to country, but the deterioration in the living standards of the poor is so pressing and the national situations sufficiently similar that governments should learn from experiments around the region. Failing to respond to the rise of poverty will not only be morally unsatisfactory, but will also create conditions for discontent which could derail any development strategy which ignores poverty alleviation.

The argument for fighting poverty is not just a negative one of avoiding a political backlash. There is also considerable international evidence that reducing poverty leads to fuller utilization of human resources and helps to widen the pool of potential small-scale innovators and entrepreneurs. This is related to the need for financial innovation, especially the provision of microfinance to poor farmers and other credit-constrained individuals, and often has a gender dimension, as women fit into these categories and are particularly excluded from existing financial channels. By assisting the poor to help themselves to escape the poverty trap, such financial innovations can have a big return in both alleviating poverty and promoting growth.

Consideration of the link between poverty and capabilities leads to the third day's agenda on human development, which emphasises education and health reform. Although openness, good governance, wise polices towards infrastructure and poverty alleviation will all help to promote socioeconomic development with equity, they will not allow the countries of Central Asia to realize their full growth potential without the investment in people which is both key to growth and a major direct component of human development. For national governments, non-government organizations and international agencies the question is where they can best direct their efforts to ensure that the whole package is implemented as successfully as possible.

4. Prospects for the Future

Economic policy making in the Central Asian countries has been difficult because the countries were unprepared for independence, had been tightly integrated into the Soviet economic geography, and

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non-oil sector, so that enterprise closures are desirable in the long-run. These arguments ignore (1) evidence from Krajnyák and Zettelmeyer (1997, 45) that Kazakhstan may be one of the few transition economies that had already used up the scope for real appreciation by 1996 and (2) the problems caused for new enterprises producing traded goods, which should be key elements of a future diversified economy.

15 Sachs and Warner (1995) have documented a statistically significant negative relationship between natural resource abundance and economic growth over the last two decades.

included some of the poorest Soviet republics. By 1998, however, the Central Asian countries have essentially completed the first phase of economic transition from the centrally planned Soviet economic system, establishing a market economy where relative prices play the main allocative role, unobstructed by hyperinflation. The process has been difficult, involving several years of sharply declining average living standards and unaccustomed widening of income differentials as well as substantial non-economic problems such as increased crime and stress levels. The approaches to this phase varied, and the imprint of the differing strategies, as well as other differences in starting point, will impact on the second phase of national economic development when the countries seek to establish self-sustaining growth with equity.

Does a more reformed economy provide a better springboard for long-term growth? One issue for the next decade will be whether the gradual strategy pursued by Uzbekistan has long-term costs which will outweigh the short-term benefits of a more limited output loss. The Kyrgyz Republic and, to a lesser extent, Kazakhstan have gone further in establishing a market-based economy. The Kyrgyz Republic is, however, hampered by its poorer resource base and geographical isolation. Kazakhstan has the greatest potential with its abundant energy and mineral resources and higher initial endowment of human capital, although it has the most acute ethnic divisions which could hamper economic development.[16] Turkmenistan's strategy of minimizing systemic change was clearly unsustainable and being rethought by 1997, while Tajikistan's choice of strategy and ability to follow consistent policies have been frustrated by political uncertainties.

Despite the variations in resource endowment and transition strategies, all of the Central Asian republics have the potential to raise living standards by 2010. The successful formulae will include openness, good governance and concern for the poorer members of society. Attracting foreign investment and raising domestic savings rates will be important, but more significant will be empowering the people through provision of education and health services and an environment in which people can use their human capital to the benefit of society as well as themselves. A market-oriented economy is a well-tried framework for achieving such an outcome, but it only produces the desired results if the broad infrastructural conditions (including good policies) are right.

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[16] At independence, just over two fifths of the population was reported as Kazakh, two fifths Russian and about a fifth other groups. Since 1992 there has been substantial emigration, especially from northern Kazakhstan, and the decision to move the capital from Almaty in the southeast to Astana (Akmola) in the centre-north is widely seen as a response to the ethnic issue; it will impose large economic costs.

Table 1: Socioeconomic Indicators

	Population	Pop. growth	Infant mortality	Life expectancy	GNPPC
	(million)	ave. annual %	per 1000 live births	years (male/female)	(US$)
	1996	**1980-96**	**1996**	**1996**	**1996**
Kazakhstan	16	0.6	30	60/70	1350
Kyrgyz Rep	5	1.4	26	62/71	550
Tajikistan	6	2.5	32	66/72	340
Turkmenistan	5	3.0	41	62/69	940
Uzbekistan	23	2.3	24	66/72	1010

Source: World Bank *World Development Indicators 1998.*

Table 2: Output and Inflation Performance

(a) Real GDP (index: 1991 = 100)

	1991	1992	1993	1994	1995
Uzbekistan	100	89	87	84	83
Estonia	100	78	72	72	74
Belarus	100	90	81	71	63
Turkmenistan	100	95	85	68	61
Russia	100	81	74	65	58
Latvia	100	65	54	56	56
Kyrgyz Rep.	100	81	68	55	55
Lithuania	100	62	51	51	53
Kazakhstan	100	86	76	57	52
Ukraine	100	83	71	55	48
Azerbaijan	100	78	60	52	47
Moldova	100	71	70	48	47
Armenia	100	47	40	43	46
Tajikistan	100	71	63	50	44
Georgia	100	55	41	37	35

Source: IMF staff estimates, reported in Horton (1996, 19 & 22).

(b) GDP growth rate (average annual percent)

Country	1971-80	1981-9	1990-6
Kazakhstan	4.4	2.0	-10.5
Kyrgyz Rep	4.4	4.0	-12.3
Tajikistan	4.9	3.3	-16.4
Turkmenistan	4.0	4.0	-9.6
Uzbekistan	6.2	3.4	-3.5

Source: World Bank *World Development Report 1996*, 173-4, and *World Development Indicators 1998*, 177-8.

(c) Average annual inflation rates (percent)

Country	1990	1991	1992	1993	1994	1995	1996
Kazakhstan	4.2	91.0	1610.0	1760.0	1980.0	180.0	39.1
Kyrgyz Rep	3.0	85.0	854.6	1208.7	280.0	45.0	30.4
Tajikistan	4.0	111.6	1157.0	2195.0	452.0	635.0	442.8
Turkmenistan	4.6	102.5	492.9	3102.0	2400.0	1800.0	992.0
Uzbekistan	3.1	82.2	645.0	534.0	746.0	315.0	54.0

Source: World Bank *World Development Report 1996*, 173-4, and IMF data for 1996 reported in Havrylyshyn and Al-Atrash (1998, 6).

Table 3: Lending Operations of the World Bank in Central Asia
(commitments in millions of US dollars by fiscal year)

	1993	**1994**	**1995**	**1996**	**Total**	**per cap.**
Kazakhstan		274	283	260	817	49
Kyrgyz Republic	60	78	77	98	313	70
Tajikistan				5	5	1
Turkmenistan			25		25	6
Uzbekistan		21	226		247	11

Note: The per capita amount in the final column is the total divided by the 1995 population estimate in Table 1.

Source: World Bank, reported in *Transition*, **8**, February 1997, 3.l

Table 4: General Government Spending, 1992-5

(a) Revenue and expenditure in Uzbekistan, Kazakhstan and the Kyrgyz Republic, and the average for all former Soviet republics (as a percentage of GDP)

	1992	1993	1994	1995
General govt. revenues				
Uzbekistan	32.3	41.5	36.0	35.0
Kazakhstan	22.9	22.3	17.1	16.0
Kyrgyz Republic	26.4	15.2	19.0	15.0
FSU average	33.1	30.3	28.6	23.9
General govt. expenditure				
Uzbekistan	50.1	52.0	43.6	42.4
Kazakstan	31.9	23.5	23.9	18.9
Kyrgyz Republic	44.6	36.8	29.6	26.9
FSU average	45.8	44.1	37.9	29.5
General govt. deficit				
Uzbekistan	18.8	9.4	6.7	3.4
Kazakhstan	7.3	1.2	6.8	2.5
Kyrgyz Republic	17.4	13.5	8.0	11.3
FSU average	13.1	12.2	7.2	4.6

(b) Allocation of general government spending (as percent of GDP)

	USSR (1989)	Kazakhstan (1994)	Uzbekistan (1994)
Education & health	7.4	4.7	16.5
Social protection	7.4	5.7	7.4
Support for the economy	14.1	11.4	12.2
Capital & restructuring	7.2	0.2	3.9
Law enforcement	0.9	1.3	...
Defense	8.0	0.8	...
Administration	0.3	0.7	1.0
Interest	0.7	0.3	...
Other	3.5	4.2	7.0
TOTAL	49.5	29.3	48.0

Source: Cheasty and Davis (1996).

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