Towards a New EU Strategy for Central Asia

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The EU's 2007 "Strategy for a New Partnership" with Central Asia (CA) coincided with a challenging and often turbulent decade. The region and the world suffered a number of major shocks over the years that followed its adoption, but recently there have also been important positive developments that offer some grounds for cautious optimism as the European Union prepares to adopt a new strategy for the region. A brief analysis of the ups and downs of the last decade provides some basis for thinking about how the EU's economic co-operation with the Central Asian states might evolve in the years to come.

A decade of challenge and crisis but also reform

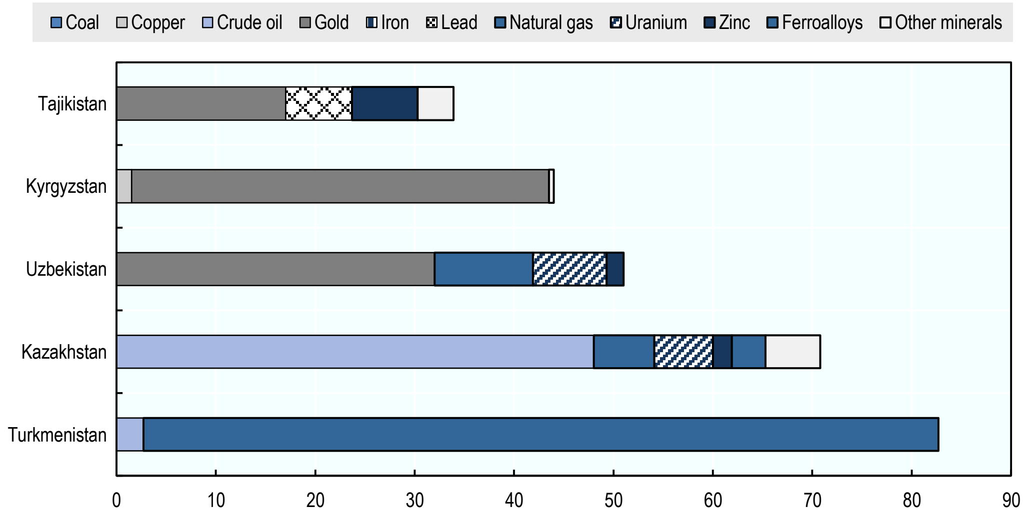
When the 2007 strategy was adopted, the so-called CA5 (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) were in the midst of a period of very strong growth, as they bounced back from the recession of the 1990s and began to reap the benefits of market reforms. On the official data, the region's real gross domestic product (GDP) grew at an average annual rate of over 8% during 1999-2008. Labour productivity growth averaged about 5% and poverty rates halved. Central Asia weathered the global crisis of 2008-09 rather well: while growth slowed, a recession was avoided and the region bounced back until the end of the commodities boom in 2013-14.[1] This second shock naturally hit Central Asia's oil and metals exporters hard. The comparatively resource-poor economies of the region also suffered, particular Kyrgyzstan and Tajikistan. They rely heavily on trade with, and remittances from, the oil exporters, particularly Russia and, to a lesser degree, Kazakhstan. Since 2014, Central Asia has also felt the impact of western sanctions and Russian counter-sanctions on trade flows, which led to significant bottlenecks and disruptions. Real GDP growth, on the official data, averaged just 3.7% during 2015-17 (in *per capita* terms, under 2%).[2]

These developments threw into sharp relief some of the structural vulnerabilities of the Central Asian economies. In particular, they have relatively concentrated export profiles – particularly in terms of goods exported (Figure 1) but also, in many cases, heavy reliance on a few key export markets. Moreover, the data suggest that for most Eurasia countries, the commodity concentration of exports was increasing in many countries in the years preceding the present slowdown.

For Kyrgyzstan and Tajikistan, of course, the primary export commodity is really labour: ILO estimates suggest that almost 30% of the Kyrgyz labour force works abroad and the corresponding figure is perhaps as much as 40% in the case of Tajikistan. In both countries remittances received in 2017 amounted to more than 30% of GDP. Since the great bulk of migrants work in Russia or Kazakhstan, the Kyrgyz and Tajik economies are powerfully affected by the oil exporters' business cycles: remittances fell sharply in 2014-15, as the Russian and Kazakh economies slowed and both the rouble and the tenge were devalued. In addition to a high degree of sensitivity to the performance of the receiving economies, this dependence on migration and remittances also implies substantial social costs, particularly for left-behind women and children, and it can leave important gaps in the domestic labour market. Reliance on migrants' remittances is thus an unappealing long-term strategy.

Figure 1. Exports of mineral commodities by Central Asian countries

% share of total exports in 2015



Source: OECD, based on data from the Observatory for Economic Complexity, 2017.

To a great extent, these macroeconomic fluctuations explain why Central Asia's economic relationship with Europe has not developed more dynamically over the last 10 years. Total trade turnover between the EU and the CA5 grew by just 15.2% over 2007-15; the EU is Kazakhstan's largest trading partner, but Europe ranks just fourth for Tajikistan and Uzbekistan, and fifth for Kyrgyzstan. From a European perspective, too, trade with Central Asia is even less important: in 2017, the CA5 accounted for about 0.7% of total EU trade with the rest of the world. The region is somewhat more important in terms of FDI flows but these are highly concentrated. Kazakhstan hosts about 95% of the EU FDI stock in the region (€47.7bn in 2015, about half of all inward FDI into that country), with Uzbekistan a very distant second (€2.5bn).

Yet if the last decade has been relatively disappointing in terms of EU-Central Asian economic relations, a number of recent developments suggest that now is the right time for a renewed EU Central Asia Strategy:

- **Economic reforms** have accelerated. The shocks of 2014-15 prompted governments in the region to adopt important, and in some cases long overdue, measures, with a strong focus on improving the business environment. While implementation has been uneven, this work continues; the end of the commodity super-cycle has driven home the need to create the conditions in which real diversification of economic activity and exports can occur.

- **Regional co-operation** is improving in ways no one could have anticipated just a few years ago. This is largely but not only the result of the opening up of Uzbekistan, which since late 2016 has been energetically pursuing closer relations with its neighbours and has launched important reforms of the business climate, judiciary, administration and security services.

- Growing interest in **connectivity** across the Eurasian landmass – not only China's "Belt and Road" initiative (BRI) but also other large-scale visions for improving trade and transport connections linking East and South Asia to Europe[3] – offers enormous opportunities to Central Asia.

These shifts have already begun to create a new dynamic in Europe's relations with the region. Kazakhstan concluded an Enhanced Partnership and Co-operation (EPCA) with the Union in December 2015, Kyrgyzstan and the EU began talks on an EPCA in October 2017 and Uzbekistan is now interested in following their lead, something that Brussels has welcomed.

Priorities for a new strategy

So what can we say about the future of EU-Central Asian economic co-operation in light of these developments?

First, the economic diversification agenda, which was at the heart of the 2007 strategy's discussion of economic development, trade and investment, is now more important than ever. It was the right priority even in 2007, but many in the region failed to appreciate its significance. While policy makers in Central Asia did discuss diversification in the boom years prior to 2008, they did relatively little about it. The risks associated with export concentration and commodity dependence were still largely theoretical. After 2013, though, those risks began to materialise. In response, governments across the region have launched reforms intended to improve the business environment, and the diversification theme has taken on a new urgency.[4]

The OECD's experience in the region confirms this. For a decade now, our Eurasia Competitiveness Programme has worked with Central Asia, financed in large part by the European Union and strongly focused on private-sector development. In recent years, we have seen a significant increase in demand from Central Asian governments for work on business environment reforms, particularly those contributing to the diversification of production and exports.[5] When it comes to private-sector development, the EU clearly has much to offer Central Asia, not least because neither of the region's two large neighbours, China and Russia, have traditions of private sector-led development themselves. An EU-Central Asia policy dialogue on private-sector development, underpinned by concrete TAIEX activities on the ground, should be a central component of the new strategy's economic pillar.

Closely linked to this agenda are two domains in which EU support could advance both economic diversification and more inclusive societies, as well as political and security goals: improved support for returning migrants and greater educational opportunity.

While labour migration has done much to sustain consumption and reduce poverty in Tajikistan, Kyrgyzstan and, to a lesser extent, Uzbekistan, it is more of a coping mechanism than a basis for sustained growth and development. Moreover, there is much that could be done to turn returning migrants into a real economic resource for the sending countries, especially if migrants return with professional skills acquired abroad. However, to a great extent, this depends on creating an environment in which returning migrants can generate new activities: they often tend to be among their countries' most entrepreneurial citizens. Improving the framework conditions for entrepreneurship – which is central to any meaningful diversification policy – could make a huge difference here.[6] OECD work in Tajikistan, for example, highlights the policy changes and institutional reforms that can help improve these conditions and maximise the potential contribution of returning migrants to national economies.[7] The political dimension of this activity should not be overlooked, since some recent work suggests that returning migrants who find no suitable opportunities at home are among the groups most likely to be radicalised.[8]

In addition to supporting reforms aimed at improving framework conditions for business, the EU could work more closely with Central Asian governments, as well as local and international NGOs and other development partners, to provide returning migrants with basic accounting and other skills needed to start a business. This would not only increase the likelihood of entrepreneurial success, it would also increase the probability that migrant start-ups operated in the formal sector. Managerial skills are critical not just to firm survival but to growth and productivity. In the words of LaPorta and Shleifer, "The evidence suggests that an important bottleneck to economic growth is not the supply of better-educated workers... Rather, the bottleneck is the supply of educated entrepreneurs—people who can run productive businesses."[9]

“Youth and education” constituted an important pillar of the 2007 strategy, and they should remain a major focus in future. This is where EU “soft power” intersects with economic co-operation, and much more can be done, not least to expand the scope of educational exchanges – the region’s participation in programmes like Erasmus has hitherto been fairly limited. Support could also focus on fields in which skills are scarce, such as engineering and IT.

Finally, the connectivity agenda is now coming into its own. Looking back at the 2007 strategy, it is striking how narrowly the section on “Strengthening energy and transport links” was drafted: it is devoted entirely to energy issues – exploration, extraction, transport and security. The previous strategy mentioned the EU’s TRACECA[10] initiative and made reference to Central Asia’s potential as “an important trade corridor” but offered no concrete commitments on issues of transport connectivity, except those concerned with energy. This has, of course, changed, and the EU, like other major external actors, is increasingly engaged in the discussion of Euro-Asian connectivity. Connectivity has become increasingly prominent on the agenda of the Asia-Europe Meeting (ASEM) in recent years.

The new strategy should strengthen the emphasis on trade and connectivity, but should also broaden it: it is not just about East-West flows but also about North-South connections. Indeed, the failure of the 2007 strategy to mention India was an unfortunate lacuna that should be corrected, so that the strategy fully situates Central Asia in its economic and geographic context. It should also address connectivity challenges within the Central Asian countries and among them; otherwise, improved East-West connectivity risks leaving them as passive transit routes, through which other people ship goods. The International Transport Forum at the OECD is currently completing an analysis of the region’s networks, which will be published in early 2019. The preliminary findings point to important emerging bottlenecks and weak logistics performance, as well as some questionable choices about what infrastructure to build and where to build it, and poor asset-management and maintenance policies.

Yet physical infrastructure is only part of the story. Although potential investments in infrastructure mega-projects have generated much excitement, there is also a growing awareness of the need to work on other dimensions of connectivity, including trade policy and trade facilitation, customs policies and border formalities, and policies governing information and communications technologies. In many respects, this is a no-regrets strategy, since even in the absence of initiatives like the BRI, the CA countries would have much to gain from better trade facilitation, “thinner” borders and a more sophisticated understanding of transport policy. In many places, the Ministry of Transport has, historically, been a ministry of road construction, with an aviation ministry or state-owned airline running the airports and the railways operating as an independent state-owned company. Much remains to be done to equip Central Asian governments with the tools needed to craft and implement multi-modal, evidence based and strategic transport policies that are aligned with economic development objectives.

The OECD is already working with the CA states on connectivity issues, with a strong focus on building their policy capacities: the point is not to promote or impede the BRI or any other vision of connectivity but to help the Central Asian governments understand how to make the most of opportunities for enhanced transport connectivity and international integration.

The EU is in a particularly strong position to work with Central Asian countries on these “softer” connectivity challenges. Its construction of the single market, its experience with the TEN-T corridors and its leading role in liberalising diverse modes of freight transport make it a reference point for many in Central Asia, as we are seeing in our own work there – we find great interest in EU perspectives and experiences across the region.

In important respects, efforts to promote improved economic governance can be pursued in tandem with work on connectivity and diversification: our work on these issues is consistently linked to better governance, since the issue is not only *what* to do but *how* to do it. Our work on transport policies and infrastructure, for example, looks not only at freight models and projections to see where demand is growing and bottlenecks may emerge. It also considers the public governance of infrastructure supply and operation, introducing policy-makers and officials in the region to relevant OECD instruments and practices in such fields as public procurement and competition, drawing on the "OECD Framework for the Governance of Infrastructure."[11] One advantage of this approach is that it introduces best-practice models of governance not in highly prescriptive or normative terms but in a context that links them directly to key economic policy priorities: in other words, better governance is not merely something policy-makers *should* pursue, it is also something that will help them achieve their objectives.

Finally, no strategy for economic engagement with Central Asia will be complete without an important environmental component. This is not a new area for EU engagement or for the OECD – our GREEN Action Task Force has been active in the region for more than a quarter-century. However, recent developments suggest both a new opportunity and a new urgency to intensify the engagement here. The new opportunity stems above all from the improving relationships between Uzbekistan and its neighbours, while the urgency arises from the development of the BRI. Uzbekistan's opening has, in particular, created an opening for progress in addressing Central Asia's water challenges. The GREEN Action Task Force has long supported national policy dialogues on water but transboundary waters – which in Central Asia are critical to the entire water-food-energy nexus – have been much more difficult owing to conflict between up- and down-stream states. That has begun to change.

At the same time, the progress of the BRI makes green infrastructure more important than ever. In light of the Paris Climate Agreement and the 2030 Development Agenda, it is imperative to ensure that investment decisions are compatible with these goals, and are thus sustainable, low-carbon and climate-resilient. As infrastructure is by nature long-lived, investment decisions being made today can lock in development patterns ("green" or "brown") for decades to come. The OECD is actively promoting greener infrastructure in the region and we would urge the EU to make this a central focus of its environmental engagement in the new Central Asia strategy.

Conclusion

Those who know Central Asia well will not find anything revolutionary in these proposals. In many ways, they are extensions of the priorities already expressed in the 2007 strategy. The difference now is that the international context may be somewhat more favourable to progress, not least because the resource boom is over and the countries of the region are more aware than a decade ago of the need for reform. The region is ready, perhaps as never before. And the international community must be, too.

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[1] OECD calculations on the basis of World Bank data. Given the questionable quality of some Central Asian countries' official data, these estimates are likely to be high of the mark but they dynamic they depict – and the changes in that dynamic – seem to be correct. For an overview of trends and performance in the region, see OECD (2018a), *Enhancing Competitiveness in Central Asia*, OECD Publishing, Paris, especially Chapter 1.

[2] The slowdown was almost certainly sharper than these figures suggest, for two reasons: first, data for Turkmenistan and Uzbekistan show almost no slowdown, despite their hydrocarbons exports; secondly, the falling terms of trade mean that the aggregate purchasing power of the population in many countries contracted even if a GDP contraction as avoided: see OECD (2018a) and OECD (2018b), *Reforming Kazakhstan: Progress, Challenges, Opportunities,* OECD, Paris, pp. 21-22.

[3] Other initiatives undertaken in recent years address both north-south and east-west axes, including the US "New Silk Road" initiative in 2011, the EU's TRACECA initiative, which Europe has sought

to reinvigorate, and the "Free and Open Indo-Pacific Strategy" promoted by the US, Japan, Australia and other partners in the region.

[4] This emphasis can be seen in strategic policy documents across the region, including Kazakhstan's strategy to 2025, Tajikistan's 2030 strategy, and the economic programmes of successive Mongolian governments and the export diversification drive of the government of Uzbekistan since 2016. For more detail, see OECD (2018a).

[5] For an overview of work done during 2015-17, see OECD (2018a).

[6] Indeed, poor framework conditions at home are among the major causes of migration; see E. Marat (2009), "Labor Migration in Central Asia: Implications of the Global Economic Crisis", *Silk Road Paper*, John Hopkins University, Baltimore; and I. Malyuchenko (2015), "Labour migration from Central Asia to Russia: Economic and Social Impact on the Societies of Kyrgyzstan, Tajikistan, and Uzbekistan", *Central Asia Security Policy Briefs*, Norwegian Institute of International Affairs and OSCE Academy, Bishkek, February.

[7] See OECD (2018), chapter 2 and OECD (2015), *Enhancing Access to Finance for SME Development in Tajikistan*, OECD, Paris.

[8] Nushofarin Noziri (2018), "North, West, Home Best. Tajik Labour Migration and EU Development Cooperation", EUCAM Commentary № 30, July, https://eucentralasia.eu/2018/07/north-west-home-best-tajik-labour-migration-and-eu-development-cooperation/.

[9] Rafael LaPorta and Andrei Shleifer (2014), "Informality and Development", *Journal of Economic Perspectives*, 28:3, p. 125.

[10] Transport Corridor Europe Caucasus Asia.

[11] See OECD (2016), *Getting Infrastructure Right: The Ten Key Governance Challenges and Policy Options*, OECD, Paris, http://www.oecd.org/gov/getting-infrastructure-right.pdf.