

Contribution to the upcoming report by the Eurasian Council on Foreign Affairs (ECFA) on the European Union's proposed new Strategy for Central Asia

Hans Holzhaecker, EBRD Lead economist for Central Asia

The EBRD has been active in the Central Asian region since 1996. Based on this lengthy experience and the Bank's mandate and transition concepts, the EBRD suggests a set of policies to be recommended for inclusion in the European Union's new Strategy for Central Asia.

EBRD's activities and strategic priorities in Central Asia

As of mid-2018 the EBRD has cumulatively invested around € 10 billion in more than 650 projects in the five Central Asian countries. The EBRD's current portfolio of projects stands at over € 3 billion. While Kazakhstan has received the largest share of the Bank's investments in the region, the EBRD has been stepping up its activities in Uzbekistan since 2017 in support of the impressive reform efforts launched by the government.

The EBRD's support for transition in Central Asia focuses on key strategic priorities in the region, such as private sector development, green economy, connectivity and integration, as well as inclusion, with special emphasis on gender issues. EBRD investments span over a broad range of sectors: infrastructure and energy, agribusiness, manufacturing and services, financial institutions, ICT. The Bank provides financing for improving the quality and sustainability of municipal services and building efficient, reliable and secure transport systems. Activities in the power and energy industry have included investments in heat and hydro generation, transmission and distribution, safety and climate adaptation upgrades and increasingly in renewables. The EBRD has financed a range of natural resources projects with emphasis on environmental sustainability and transparency of the sector. The EBRD has also supported the tourism sector across Central Asia, including under the Cultural Heritage Framework launched in Uzbekistan. In line with its mandate, the EBRD is especially engaged in projects and activities that promote the private sector and entrepreneurship, supporting SMEs, which are critical for creating jobs in the region and enhancing inclusion, through advisory services and investments and paying particular attention to the development of women entrepreneurship.

EBRD projects and policy engagement encourage broad sector reforms aimed at building open and efficient market economies in the region. The Bank has been promoting tariff reform and commercialisation of municipal services; energy sector reform and the development of a renewables legal framework; commercialisation and potential privatisation of SOEs; introduction of Private-Public-Partnerships. The EBRD engages in legal reform to create investor-friendly, transparent legal environments and promotes improvements in the business climate including by supporting Investment Councils in Tajikistan and Kyrgyzstan and a Foreign Investment Council in Kazakhstan that help identify and remove obstacles for domestic and foreign investors.

The EBRD also manages remediation activities on the uranium legacy sites in Kyrgyzstan, Tajikistan and Uzbekistan under the EU funded Environmental Remediation Account for Central Asia (ERA).

EU Support for Central Asia through the EBRD

EU grants for technical cooperation and investment co-financing and other support for EBRD's activities and projects in Central Asia have been essential for their success. The EU channels its funding for Central Asia mostly through IFCA (Investment Facility for Central Asia) as well as regional and bilateral country allocations. The EBRD has received around €150 million over the last five years from the EU in technical assistance and investment grants with the Kyrgyz Republic and Tajikistan, the poorest countries in the region, benefiting most from the EU grants.

The EU funding is helping the EBRD address the lack of capacity in municipalities to prepare bankable projects to improve essential infrastructure services and successfully implement them. The investment grants are crucial to address severe affordability constraints for critical investments in municipal infrastructure and energy projects.

EU funding for EBRD advisory services for SMEs supports capacity building and efficiency improvements, marketing, and business development, and is playing a vital role in improving SME access to financing. EU funds form an important part of financing packages, including risk sharing facilities and incentive payments used for the SME development.

EU funding is also very important for EBRD projects promoting energy efficiency improvements to reduce the high energy intensity of the Central Asian economies through advisory and investment support. Without EU support many of the Bank's projects could not be implemented. It would be important to maintain under the new EU Strategy for Central Asia technical assistance and grant funding for infrastructure, , sustainable energy and assistance to SMEs; further stepping up of co-financing towards green, innovative and economically and socially inclusive projects would be highly welcome and essential for the region's development.

The EBRD concurs with the European Council on the basic principles for the upcoming new CA strategy

The EU's 2007 "Strategy for a New Partnership"¹ with Central Asia stated that the EU has a strong interest in a peaceful, democratic and economically prosperous Central Asia. It also stated that prosperity in Central Asia is to be brought about by the development of

- a stable democratic political framework,
- functioning economic structures,
- respect for the rule of law,
- human rights,
- good governance,
- independent judiciary.

At its meeting on 19 June 2017, the European Council emphasized that the basic principles of the 2007 strategy remain valid, but expressed the need of updating the strategy².

The Council's "Conclusions" specifically focus on

- capacity building and education
- promoting a reliable and attractive climate for sustainable and responsible investments,
- sound regulatory frameworks, and their transparency and stability,
- involvement of the business community in decision making.
- integration of the Central Asian countries with each other and into international markets.

The EBRD's mandate and thinking is very much in line with the statements of the 2007 strategy and the EBRD also concurs with the Council on which areas are highly relevant for the updated strategy.

Article 1 of the Agreement Establishing of the EBRD defines the purpose of the Bank "to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to applying the principles of multiparty democracy, pluralism, and market economics".

On 2 November 2016, the Board of Directors refined the EBRD's concept of progress towards a sustainable market economy introducing six key "transition qualities": competitive, well-governed, green, inclusive, resilient and integrated. The refinement accounted for key lessons learned about transition: it is not only about building markets, but also about redesigning the state; in order to avoid reversals, one needs to build not just a competitive, but also a well-governed and inclusive market economy; the crisis of 2008 brought home the role of economic resilience - banking panics, volatility of asset prices, as well as of food and energy prices, undermine the support for market economy. The urgency of environmental sustainability and green transition has become clearer by the day and has been codified at the 2015 Paris Climate Convention. Given the rising populist backlash against globalisation, supporting integration is especially important.

Winds of change

The EU is formulating its new strategy towards Central Asia in a time characterized by a number of major global developments, which will significantly impact both Europe and Central Asia, and the relation of the two regions with each other:

- the rise of Asia's - especially China's - economic power
- the global green transition,
- the digital technological push and the transition to the "industry 4.0"

These developments will shift the strategic focus of the EU's engagement with Central Asia even more than before towards issues of connectivity, energy efficiency, green technologies, digitalization, know-how and capacity building and technology transfer.

Central Asia is in many ways strongly affected by these developments. It is a major transit route for trade flows between the EU and Asia. Most importantly, increased EU-Asia connectivity will provide opportunities for a better inclusion of Central Asian businesses into global value chains. The opening up of Uzbekistan offers new opportunities for regional integration, allowing a better use of economies of scale, resulting in a higher weight of the region in the global economy. While Central Asia will remain an important supplier of energy, metals and other natural resources, there is a strong potential for advancing cross-border trade in agricultural and food products, for tourism, and other goods and

¹ "The EU and Central Asia: Strategy for a New Partnership", Council document 10113/07 of 31 May 2007

² "Council Conclusions on the EU strategy for Central Asia", Council document 10387/17 of 19 June 2017

services. The large European market is among the most important export destinations for Central Asian producers, though both regions still have to work to improve the access to this market, bilaterally and also via support for joining WTO for the Central Asian countries not yet being members.

Change management for mutual benefit

In order to enable Central Asia – and the EU – to benefit from enhanced connectivity, trade and investment brought about by transcontinental transport corridors, sponsored by the EU, China and others, an increase in Central Asian competitiveness as well as transnational coordination and strategies mitigating potential negative effects from import competition on employment, environment and welfare are needed. Investments have to be made according to international standards and in line with the debt service capacity of the countries of the region.

More than ever the development of strong institutions supportive of investment and business activities and of private sector development and engagement will be required to advance technological change. Stepping up capacity building and education will be necessary both for the provision of advanced production capabilities and for providing employment opportunities for youth, women and less developed regions and their participation in growing welfare.

Central Asia has much to gain from European know how and investment. Support for more efficient natural resource usage and the region's green transition is of special importance, given Central Asia is one of the most energy and carbon intensive regions of the world.

EBRD recommendations / wish list for the EU's new CA strategy

The EBRD is very active in supporting economic and ecological change in Central Asia, and in promoting institutional frameworks conducive for private sector development and engagement.

Inspired by the six quality concept, the EBRD suggests include into the EU's new strategy instruments, facilities, advisory initiatives that encourage Central Asian governments, businesses and societies to adopt and strengthen policies supporting:

Competitive

- regulation that facilitates entrepreneurship, market entry, and the upgrading of business standards
- regulation and investments that help the development of the SME sector and the growth of SMEs
- measures and regulation facilitating foreign direct investment and a level playing field between domestic and foreign-owned firms

Well-governed

- regulation that enhances the accountability, regulatory quality, government effectiveness and transparency at the sectoral and national and subnational levels
- measures and regulation aimed at the improvement of the governance of firms and organisations, corporate structures and reporting standards
- measures and regulation aimed at increasing the transparency and quality of natural resource management and the granting of licenses in the mining sector
- measures and regulation aimed at improving the predictability, transparency and accountability for the provision of infrastructure services
- privatisation of state owned enterprises and other undertakings to increase the private sector share in the economy such as PPPs.

Resilient

- measures and regulation supporting sound banking and promoting access to finances
- measures and regulation aimed at making banking systems well capitalised, liquid, with a well diversified funding base, not exposed to severe currency and maturity mismatches
- effectively supervised and implemented regulatory frameworks that induce adequate governance structures and risk management practices in banks
- functioning capital markets, including those that provide private equity and venture capital and other non-bank sources of access to finance
- measures and regulation in the energy sector to develop market structures and institutions that provide reliable and transparent energy price signals to which private investors can respond by building the right type of infrastructure at the right time and in the right place

- regional integration of energy markets in order to promote supply diversification and enable the private sector to deliver the right products at competitive prices
- efforts to improve the financial sustainability, robustness and independence of transportation and telecommunications and municipal infrastructure services providers

Integrated

- measures, regulation and investment supporting the international expansion of local players, diversifying firms' supplier base across borders, especially also within the Central Asian region
- measures, regulation and investment improving international connectivity of transport and ICT infrastructure.
- associate reform efforts that facilitate cross-border institutional integration to simplify administrative processes and allow better regional integration between authorities, operators and other stakeholders
- trade facilitation and FDI, especially in sectors other than mining, oil and gas and metals such as agribusiness, textile and apparel, and tourism.
- building capital markets infrastructure
- the expansion of electricity networks, gas networks or retail petrol stations to new regions and cross-border interconnection

Inclusive

- expanding employment and training opportunities for groups of people that are currently facing reduced opportunities such as: young people, women and local populations in less developed regions
- training programmes aimed at vocational as well as higher technical levels, work-based learning opportunities
- policies and practices that promote diversity in the workforce and
- measures and regulation to improve national skills standards that reflect current and expected future labour market needs,
- measures and regulation that address regulatory barriers, particularly in relation to women, that limit access to jobs
- measures and regulation that support the participation of women-led businesses in the economy, including through supply chains and gender responsive procurement practices
- projects that can provide financing and advise to benefit those groups which face disproportionate barriers in the formal financial system.

Green

- the use of low-carbon and clean energy sources/technologies that mitigate climate change and reduce air pollution.
- improvements in energy generation, transmission and distribution, energy efficiency measures, and increased use of renewable sources of energy.
- measures and regulation that help reduce emissions
- a modal shift from higher to lower carbon and less polluting transport modes
- measures, regulation and investment in environmental infrastructure such as waste management, water supply and waste water treatment;
- measures, regulation and investment to adapt infrastructure to cope with the impacts of climate change
- financing facilities that support the minimisation of environmental impacts and facilitate adaptation to a changing climate
- green financing facilities and financial instruments