Journal of International Development: Vol. 9, No. 4, 579–587 (1997)

UPHEAVAL ALONG THE SILK ROUTE: THE DYNAMICS OF ECONOMIC TRANSITION IN CENTRAL ASIA

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Abstract: This paper discusses, in a comparative manner, the dynamics of economic transition in the Central Asian republics of the FSU (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan), since their independence. The collapse of the Soviet Union in 1991, the reform policies that were implemented and the new external market environment, are seen as important factors to explain the dramatic economic crisis that is still continuing. The paper makes a plea to recognize the diversity and complexity of the economic transition in Central Asia and show the necessity for a speedy economic recovery, in view of possible serious conflicts that can emerge in and between the countries that are situated along the old 'silk route'. © 1997 by John Wiley & Sons, Ltd.

J. Int. Dev. **9:** 579–587 (1997)

No. of Figures: 0. No. of Tables: 2. No. of References: 22.

INTRODUCTION

This article analyses the dynamics of economic transition in the five Central Asian States (CAS) Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, during the first half of the 1990s. In the Soviet era, the CAS structurally benefited from the 'All-Union Budget' transfers, financing investment in agricultural, industrial and mining infrastructure or social sector development. Nevertheless, the FSU had a rather one-sided inter-republican division of labour, with countries such as Uzbekistan, Turkmenistan and Tajikistan specializing in cotton ('white gold'); Kyrgyzstan emerging as a major wool producer and a supplier of uranium, gold and mercury; and Kazakhstan becoming a bulk grain producer, expanding the cultivated area with the 'virgin lands campaign' of Khrushchev, while simultaneously with Turkmenistan boosting oil and gas production. This model gave rise to dependency

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CCC 0954–1748/97/040579–09$17.50

Table 1. GDP of the CAS (1990–1995).

Annual Growth (%)	1990	1991	1992	1993	1994	1995
Kazakhstan	−0.8	−11.8	−13.0	−12.9	−25.0	−8.9
Kyrgyzstan	3.2	−4.2	−16.4	−16.4	−26.0	−6.7
Tajikistan	−1.6[a]	−8.7[a]	−31.0	−7.13[b]	−21.3[b]	−12.4
Turkmenistan	1.8[a]	−4.7[a]	−11.0	−6.0	−15.0[c]	−9.3
Uzbekistan	1.6	−0.5	−11.1	−2.4	−4.0[d]	1.2

Notes:
[a]As reliable estimates for GDP are lacking, Net Material Product (NMP) growth is used.
[b]EIU (1995) estimated NMP growth at −27.6 and −20.0 per cent for 1993 and 1994 (suggesting a somewhat greater drop in GDP). The 1994 figure taken from StatKom SNG (1995).
[c]EIU (1995) estimated NMP growth in 1994 to be positive (!) at 1.7 per cent. The different GDP figure of the CIS Statistical Committee is used here. Differences cannot be explained but the EIU suggests that the original IMF estimate cannot be justified.
[d]EIU (1995) gives −2.6 per cent for 1994. StatKom SNG (1995): −3.5 per cent, World Bank (1995): −4.5 per cent.
Sources: EIU (1995); Zhukov (1995); World Bank (1994a,b); Spoor (1995); StatKom SNG (1995, 1996); EIU (1996). Author's calculations.

on monocultures and a ruthless exploitation of natural resources (Rumer, 1989; Martin, 1994). Because of the structural dependency between the CAS and the 'centre', the *dis*integration of the Soviet Union had a dramatic impact. In the following the transitional process, the reforms and the complexity of the outcomes in the CAS are discussed.

CONTRACTION AND CRISIS

All CAS suffered from severe economic contraction in the past years (Table 1). Compared with 1990 the accumulated reduction in real GDP by 1995 was dramatic: Kazakhstan and Kyrgyzstan (46 per cent), Tajikistan (36 per cent), Turkmenistan (64 per cent) and Uzbekistan (82 per cent), having a rather mixed performance in relation to the CIS average (58 per cent).[1] Recent estimates for 1996 show that the bottom-line was reached in Kazakhstan and Kyrgyzstan, who resumed—still meagre but—positive growth, while Uzbekistan showed zero growth (EIU, 1996).

Transition and Sectoral Development

Apart from their large agricultural sectors (in terms of employment and sectoral contribution to GDP), the CAS had important industrial and mining sectors when they became independent. Nevertheless, in the first years of transition the disintegration of vertically integrated production and marketing chains hit the latter sectors particularly hard. Outdated production processes could not compete with cheap imports (such as from China and Turkey), and there were growing shortages of energy, transport and skilled labour. Privatization of industry advanced more than in

[1] StatKom SNG (1996, p. 11). In the *World Development Report* (1996) the CAS all score quite low in the WB's Reform Index (with Kyrgyzstan as front-runner). Nevertheless Uzbekistan was economically the 'best-performer'.

agriculture (in particular in Kazakhstan and Kyrgyzstan), through company buy-outs, voucher programmes and spontaneous *nomenklatura* privatization (Lavigne, 1995), but state-owned and private industrial enterprises alike are still in bad shape, as newly emerging financial, input and output markets are still inefficient and segmented. Industrial recovery in the CAS is therefore a slow and painful process (Henley and Assaf, 1995, pp. 239–241). The agricultural sector was somewhat less affected during the first half of the 1990s, although grain production in Kazakhstan showed dramatic declines in 1991 and 1995, and also in Kyrgyzstan a severe contraction took place.[2] Major agricultural export commodities found new markets (such as cotton), which provided hard currency to import inputs. Furthermore, while the terms of trade did not improve for most crops, privately produced — high value — agricultural products such as vegetables somewhat countered the drop in overall output and agricultural incomes.[3]

The Land Question: Slow Transformation

Land is 'privatized' in a variety of ways, which makes it also difficult to assess what share of agricultural land is currently in private ownership and usufruct. State farms transformed into joint-stock companies or cooperatives, collectives into limited liability companies (*tovarishchestva*) or leasehold companies, sometimes representing not more than paper changes.[4] There is also wide-spread introduction of leased *usufruct* rights (Kazakhstan, Kyrgyzstan and Uzbekistan). In Uzbekistan 500,000 hectares were allocated in tiny plots to peasant farmers' families. Nevertheless, there is no concerted movement towards wide-spread — economically viable — private farms.[5] In Kazakhstan, most recently, huge former state farms (*sovkhozy*) were taken over by private capital groups. Nevertheless, the agrarian transition is still a relatively gradual process.[6] New markets for inputs and outlets for agricultural production are emerging in a very slow and fragmented manner. Credit for private farmers is often not available, and the social infrastructure of education and public health is still related to the old parastatal or collective structures. The rural *nomenklatura* wants to hold on to power, while trying to control the land that is transferred into private hands (Spoor, 1995). The CAS's governments genuinely fear, that a privatization process leads to conflicts along ethnic lines, such as were witnessed in 1990 in the

[2] According to StatKom SNG (1996) the 1995 grain harvest in Kazakhstan came to a historic low: 9.5 million tons. In 1990 this was 28.5 million tons, and in 1992, 29.8 million tons!

[3] Field notes of several farm visits in the Chui Valley in Kyrgyzstan and the Chengeldy area in the south of Kazakhstan, June 1996.

[4] This aspect was brought forward by several participants from the CASs, during a World Bank/EDI Training Seminar where I lectured in Washington, January 1996, dedicated to Rural Project and Investment Analysis. The particular session was led by Roy Southworth, Team Leader of a number of CAS-Agricultural Sector Reviews done by the World Bank.

[5] In Uzbekistan the government has signed an agreement with the World Bank to undertake a comprehensive 'Farm Restructuring Study' that might be the first step towards de-collectivization and the formation of private farms.

[6] In early 1995, in Kazakhstan 22,500 farms were counted, covering 7.8 million hectares of land. This was 3.5 per cent of all agricultural land, and as share of plowland most likely not higher than 10 per cent. For Kyrgyzstan the number was 17,300 farms, with 744,000 ha (7.1 per cent) and for Uzbekistan it was 14,200 farms, with 193,000 ha (0.7 per cent), and as share of arable land around 5 per cent (Shend, 1993; StatKom SNG, 1995; World Bank 1994b; USDA, 1995).

border-town of Osh, where access to land was a major issue in the violent and bloody riots between Kyrgyz and Uzbeks. Therefore, although leasing of land (with rights of heritage, and long periods of leasehold) is an advanced step in the privatization of land, most is still owned by the state.

ECONOMIC REFORMS: HARDENING THE 'SOFT BUDGET CONSTRAINT'

The disarticulation of domestic and external markets provided a clear impetus to transform the existing financial and monetary structures in all of the CAS. Money in a socialist system had primarily an accounting function rather than an instrument for allocation of resources. Monetary relations that previously existed between the former Soviet republics were part and parcel of the planned economy, and most of the extra-republican trade — via the centre — was performed in transferable Rubles within the CMEA-trading block, that passed away alongside with the Soviet Union. With the continuation of the Ruble-zone, at least until early 1993, monetary developments in the CAS were highly influenced by the expansionist monetary policies of the Russian Federation, in particular after the price liberalization of the Gaidar government in January 1992. Large quantities of rubles entered the CAS, subsidizing state companies and national banks (EIU, 1993, pp. 30–31), and also pushing up prices. However, intra-republican enterprise arrears accumulated, in the absence of proper clearing procedures and contract enforcement (Henley and Assaf, 1995, pp. 237).

Insufficient domestic control over monetary policies, the partial collapse of the trading system, the supply contraction, price reforms and the continuing huge subsidy transfers to producers or consumers, all contributed to galloping inflation in the CAS during the post-1991 years. Inflation not only disrupted economic life, sometimes dollarizing economic transactions and making the domestic currency the least desired commodity (and therefore a 'hot potato'), but also — and more seriously — eroded the purchasing power of real wages and transfers. However, it is noticeable that inflation dropped substantially during 1995 in Kazakhstan, Kyrgyzstan and partly in Uzbekistan, because of supply–demand adjustment, and fiscal and monetary reforms in these countries.[7]

Table 2. Central Asian Republics: Consumer Price Inflation (1990–1995).

(%)	1990	1991	1992	1993	1994	1995
Kazakhstan	4.2	90.9	1513.0	1571.0	2381.4	60.3
Kyrgyzstan	3.0	88.0	906.0	1209.0	279.3	42.6
Tajikistan	4.0	85.0	913.0	2195.0	2300.0	884.0
Turkmenistan	4.6	88.0	831.0	3102.0	1608.0	1262.0
Uzbekistan	7.3	106.0	598.0	851.0	816.7	305.0

Sources: EIU (1995); StatKom SNG (1996); EIU (1996).

[7] Uzbekistan has done quite a lot in 1994 and 1995 to harden the budget constraint for SOEs and to reduce the hidden credit transfers that were highly inflationary. The reduction of inflation (in absence of most of the other reforms) is indicative for its success in this respect.

Monetary and Banking Reforms

Banking reforms have been quite extensive in Kyrgyzstan and Kazakhstan, although state influence is still large. However, some experiences of privatization of banks ended in a clear disaster for customers or share-holders, as speculation, corruption and the absence of a solid legal framework, became dominant features in the emerging money market. Government institutions that exercise indirect control over private banks are still underdeveloped. There are clear signs of change, but the financial infrastructure that is needed for the transition to a market economy is still rather weak, while concentrated in only particular niches of the market (Henley and Assaf, 1995). All CAS (except Tajikistan, who remained in a loose form of monetary union with Russia),[8] broke away from the Ruble-zone, introducing national currencies. This began with Kyrgyzstan, which at the advice of the IMF and World Bank launched the *Som* in May 1993, followed by the others in November that year.[9] These new currencies have severely devalued in nominal terms in the two years since their introduction.[10] In some cases, such as Uzbekistan, multiple exchange rates are still used, and devaluation was slower than domestic inflation, which enhanced a real exchange rate depreciation, worsening export positions.

Budgetary transfers from the centre were previously fundamental for the republican budgets.[11] Fiscal reforms were therefore crucial in Kyrgyzstan, Kazakhstan and Uzbekistan, with the reduction of subsidies, the introduction of VAT and excise taxes and the restructuring of fiscal institutions. In the case of Uzbekistan even water pricing is being considered as a possibility for new tax revenues (while serving as an instrument to reduce the spillage of water resources in agriculture), and in most countries consumer prices for water and energy were raised. However, the latter are still well below border prices. This is partly understandable as the regimes want to avoid a major social shock while adapting (or liberalizing) these prices. However, this policy is costly in terms of continuing subsidies that have to be financed from decreased tax revenues. Nonetheless, Turkmenistan, which wants to be the 'Kuwait of Central Asia', announced in 1992 to make energy and even water free of charge (EIU, 1993, p. 53).[12]

REAL MARKETS AND THE WINDS OF CHANGE

One of the most important (policy and externally induced) transformations in the CAS is the restructuring of the domestic and external trade system. Unfortunately this

[8] At the end of 1994, the Tajik government announced that a new currency, the Tajik Ruble would be soon released (EIU, 1995, p. 34).
[9] This early break-away policy of Kyrgyzstan, combined with the positive evaluation it received from IFIs and other donors, greatly irritated the Uzbek and Kazakh governments, a situation which — in spite of economic co-operation treaties — has not been redressed until now.
[10] The Uzbek *Som* (from 8:1 to 36:1 US$), the Kazakh *Tenge* (4.7:1 to 57:1 US$) and the Turkmen *Manat* (1:1 to 1500:1 US$). Only the Kyrgyz *Som* has stabilized during 1995 (at around 11:1 US$).
[11] For example, even in 1991 in Kyrgyzstan 35.5 per cent of the budget revenue was coming from Moscow (EIU, 1993, p. 77).
[12] In Ashgabat during a visit in December 1995, I was amazed to see that in two years time dozens of very modern hotels had been built, sometimes by ministries, or with foreign funding. Indeed, energy and water prices were non-existing or extremely low.

transformation is the most difficult one to achieve. A gradual diminishing or even elimination of the domestic state order system took place between 1992 and 1995. State procurement at administrative prices had been an integral part of the planned economic system in the CAS, but by 1995 in countries like Kyrgyzstan and Kazakhstan, most of compulsory deliveries had been abolished, except in some crucial 'strategic commodities'. In Uzbekistan the share of important agricultural crops that has to be sold to the state such as cotton was gradually decreased (to around 60–70 per cent of output in 1995), while most other agricultural product markets were liberalized. Nevertheless the mining sector remained under strict state scrutiny or ownership, although Foreign Direct Investment (FDI) is flowing in and many joint-ventures with foreign companies, including multinationals, have been set up.

Deregulation and Reregulation

Uzbekistan and Turkmenistan are pursuing a grain self-sufficiency policy since the early 1990s, shifting somewhat from cotton to wheat. This was the outcome of state intervention, as grain is nearly seen as a 'public good' for which the state has to play a regulatory role in both production and distribution.[13] In spite of the overall trend to gradually deregulate agricultural markets, in these two CAS state procurement of grain increased its relative share of output in 1993–94.[14] While parastatal procurement and distribution systems are disintegrating (such as in Kazakhstan and Kyrgyzstan, but also in Uzbekistan) still insufficient room is created for the development of private trade (Duncan, 1994). Furthermore, windfall trade activities are prevailing in the absence of a proper legal framework (commercial laws, institutions that can enforce transactions, information systems and commercial credit) and a lack of capital for investment, mostly confined to less risky trade activities.

External trade is transforming as new non-CIS markets are being explored and penetrated by the CAS.[15] Practically all trade before 1991 took place within the USSR, primary commodities were 'exported' to and processed in a more central part of the FSU. Alternative markets are needed to earn hard currency, as this is now required for imports from other CIS countries. Nevertheless, economically rather inefficient barter agreements are still being implemented between governments. The CAS are rapidly balancing their trade relations between CIS and non-CIS, although they are destined to remain within the Russian 'orbit'. From a near exclusive 'trade' (although it was more transfer) with other Soviet Republics, the share of trade with the CIS reduced to around 65 per cent in 1994, with Russia still being the most important partner.[16] The share of intra-CAS trade in the overall trade volume is around 21 per cent. Both trade with CIS and non-CIS countries for the whole of

[13] Interview with the Rector of the Agricultural University (*Selkhoz Institut*) of Ashgabad, Turkmenistan, December 1995.

[14] In Turkmenistan President Niyasov even promised free bread and flour for 1996 (EIU, 1995, p. 41), which has—in the end—not been implemented.

[15] Trade with non-CIS markets was already sharply rising during the 1992–1993 period (EIU, 1995, p. 61), a trend which was renewed (after an initial stabilization) in the years 1994–1995 (StatKom SNG, 1996).

[16] Russia represented 42.3 per cent of exports and 57.6 per cent of imports, with an overall deficit of nearly 1000 million US dollars, mainly debit to Kazakhstan.

Central Asia is nearly balanced (like the overall accumulated trade balance), but this is only true for all individual CAS in relation to hard currency markets. In their trade with the CIS, Kazakhstan and Tajikistan showed in 1994 a deficit on their balance of trade, while Turkmenistan and Uzbekistan have a substantial surplus, differences which also are reflected in the overall trade accounts. However, in 1995 Kazakhstan had already an overall positive trade balance. Uzbekistan and Turkmenistan are large exporters of energy, Kyrgyzstan and Tajikistan the main importers, while Kazakhstan (with a large potential oil production) is importer and exporter. Kazakhstan and Uzbekistan agreed late 1993 to set up a customs union, which was joined in 1994 for Kyrgyzstan. Although border trade — through 'suitcase traders' — between the countries developed quite lively since then, most of the agreement on this Central Asian 'Common Economic Space' still has to be implemented. Kazakhstan is close to Russia, having signed in 1995 an initial agreement for a customs union, while Turkmenistan wants to remain separate, opting for a 'neutral status'.

UPHEAVAL ALONG THE SILK ROAD: SOME CONCLUSIONS

Although generally Kyrgyzstan and Kazakhstan are considered as reformers, and Turkmenistan and Uzbekistan as non- (or at most partial) reformers — with Tajikistan still at war, reality is more complex. The collapse of the Soviet Union has affected all CAS in different ways, and various sets of policy reforms have been (and are being) implemented, whose effects cannot be captured within this simple dichotomy that is popular amongst the IFIs. The picture is indeed less clear than mainstream thought is suggesting and the Central Asian 'reform path' cannot be understood by noting that some have implemented reforms and others not, as is done in the most recent World Development Report on 'Transition' (World Bank, 1996). Kyrgyzstan has possibly taken the lead on the reform path, having implemented the 'shock therapy' advice of western donors to the letter. It also has been confronted with the deepest economic crisis of all the CAS.[17] Uzbekistan, who has mostly been seen as a non-reformer interestingly enough did best within the CAS in terms of containing the contraction and economic crisis, although some might say that Russian support continued for quite some time. Only recently, during 1994–95 it embarked on a programme of financial restraint, although hardly reducing its strong state intervention. In the field of financial, monetary and trade reforms Uzbekistan does not score much worse than Kyrgyzstan and Kazakhstan, and — particularly because of its political stability, and future market perspectives — has done quite well in attracting FDI (Spoor, 1995; Henley and Assaf, 1995). Indeed, policy recipes for the whole of Central Asia would certainly not do justice to the substantial structural differences between these economies. Any analysis of economic performance during the transition should be based on a thorough understanding of the particular place each country had in the FSU, the variety of reforms implemented, its political and social peculiarities, and the future position the CAS are to obtain in CIS and non-CIS markets.

[17] Yavlinski and Braguinsky (1994) note that the reform in Russia 'liberalized the inefficiencies of the previous system', while very little was undertaken to replace the planned economy by the construction of an alternative market economy. In Kyrgyzstan 'rent-seeking' activities, as economists would call them, have become the 'rule of law'.

The pressure for the leaderships to find short-cuts for economic recovery is increasing after nearly five years of dramatic economic crisis in the CAS, in spite of the positive signs of recovery in 1996. There is a danger that Central Asia could become 'as strife-ridden as the former Soviet republics in the Trans-Caucasus' (EIU, 1995), if the economic situation does not improve soon. Therefore, renewed attention to the region and a growing understanding and appreciation of the reform processes that are taking place is needed to induce forms of international assistance, economic cooperation and in particular the badly needed FDI that could improve the rapidly worsening living conditions. In case of their absence, the emerging 'upheaval along the silk route' will certainly burst out in all its — still unknown, but likely large — proportions.

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