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Central Asia 2050

Overview



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Overview

Vision 2050: an aspiration for a bold and bright future¹

Central Asia today faces great opportunities as well as daunting challenges. The region has significant potential and a unique opportunity to accelerate its economic and social development and achieve widely shared prosperity.

Under the aspirational Vision 2050, the region will have achieved widespread prosperity and living standards such that by 2050, a vast majority of Central Asians will be middle class with commensurate income and quality of life. Average per capita income will have jumped from \$10,000 in 2014 to \$50,000 in 2050 (in 2011 PPP terms). Social, institutional, and governance indicators will have improved in tandem and reached at least the levels of South Korea and Central Europe today.

Achieving this ambitious vision is plausible, though by no means pre-ordained. This requires that Central Asia successfully confronts and contends with its many challenges. Bold and sustained actions by countries will be required. Also, given the disparities of their current conditions and circumstances, national action agendas and the trajectory and speed of convergence will vary amongst the countries in the region. At the same time, the five Central Asian countries² face many common opportunities, challenges and risks.

The Setting

An ancient land, Central Asia occupies a geostrategically critical place at the heart of Eurasia. As all ancient cultures, it has witnessed many ups and downs over the millennia.

For almost half a millennium until the 16th century, the region basked in the glory of what has often been referred to as its “Golden Age.” During this period, it was at the

center of trade with the other great centers of economic and cultural life on the Eurasian land mass: the Middle East, Europe, India and China.

But this centrality was not just the result of a passive intersection of trade routes. The entrepreneurial spirit of the region’s traders, the extensive manufacturing skills of its artisans, and the deep knowledge base of its scientists made Central Asia a world leader in trade, manufacturing, and scientific fields as diverse as mathematics, geography, medicine, and astronomy—and perhaps most important of all, hydrology, which enabled the region to efficiently manage its scarcest resource of all: water.

After this “Golden Age,” Central Asia drifted into a period of decline as hostilities between rival “khans” (local rulers) inhibited contact, trade, and productive interactions within the region and more significantly, with the outside world. Centrifugal forces of division and mutual distrust continued through the Tsarist and the Soviet period but were kept in check by the central authorities in Moscow.

A central point is that the “Golden Age” of Central Asia is also an integral part of its “useable past” and thus should provide inspiration for the future.

The key lesson from this useable past is that Central Asia has thrived most when it acted the role of a “cross-roads civilization.” In this role, it was both a transformer of continent-wide economic and cultural forces and was open to innovation, ideas, and knowledge from elsewhere. Openness to the outside world and voluntary collaboration within the region generate synergies that can effectively counteract the centrifugal forces that have beset Central Asia.

The breakup of the Soviet Union in 1991 was a huge shock to Central Asia. In retrospect, it is remarkable how peaceful the transition to independence and change in economic system was within and among Central Asian, excepting Tajikistan, which faced a bloody civil war in the 1990s. However, some long-standing fissures (particularly on sharing of natural resources, principally water) between the republics in the erstwhile Soviet Union have since come

1. This report is based on a study undertaken by a team of international experts consisting of Theodore Ahlers, Cameron Hepburn, Shigeo Katsu, Harpaul Alberto Kohli, Srinivasa Madhur, Pradeep Mitra, John Nellis, Alexander Pfeiffer, Richard Pomfret, Michelle Riboud, Fred Starr, and Jonathan Walters, with Rajat Nag, Johannes Linn, and Harinder Kohli as the co-editors.

2. Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan

The region will have to complete four simultaneous transformations: from rural to urban societies; from resource based to diversified economies; from command and control economic management to market oriented systems; and from Soviet legacy institutions to those which are inclusive, transparent and accountable.

to the fore. This was further aggravated by the differing economic policy choices made by the countries. Kazakhstan, the Kyrgyz Republic, and Tajikistan showed a clear preference for market-oriented reforms, while Turkmenistan and Uzbekistan adhered to a more centrally planned economic regime.

While the newly independent countries coped with their newfound sovereignty, the economic realities of a massive and sudden drop-off of subsidies from Moscow could not be ignored. All five economies shrank dramatically following their Independence. By 1996, GDP in the two most affected countries, Kyrgyz Republic and Tajikistan, had plunged respectively to about 50 percent and 40 percent of its 1992 value. GNI per capita did not recover its 1992 level until 2009 in the Kyrgyz Republic and 2012 in Tajikistan.

Today, the five countries are at different points in the transition from planned to market economies. The Kyrgyz Republic has traveled the farthest, while Kazakhstan is close behind. Among the lagging reformers, progress in Uzbekistan has been modest and marked by episodes of progress and retreat, while Turkmenistan has substantially retained the key elements of the command economy.

All five countries are now in the middle income category³, the Kyrgyz Republic (\$1,250), Tajikistan (\$1,060), and Uzbekistan (\$2,090) are classified as lower middle income⁴ while the other two, Kazakhstan (\$11,670) and Turkmenistan (\$8,020) are now classified as upper middle income countries⁵.

By global standards, all five countries together have a small population (about 65 million people). But, as noted previously, geography puts it at a critical intersection between Europe and Asia, surrounded by large countries that have huge and fast growing markets.

This neighborhood⁶ is therefore critical for Central Asia's growth and development.

However, for Central Asia to be able to play an important role as the Eurasian land bridge and to shape its own destiny in benefiting from its potential links with its neighbors and the rest of the world, greater cooperation between these countries themselves is important. It is the totality of the Central Asian region that gives it significant geopolitical and strategic economic advantage.

It is no surprise that a region as complex as Central Asia would face a myriad of challenges both individually as countries and collectively as a region. There are several common challenges, including the efficient development of the energy and agriculture sectors; developing modern manufacturing and service industries that are well integrated into global supply chains; fostering inclusive human development; mitigating and adapting to climate change; enhancing integration with global and regional markets; and improving governance and institutions. A particular challenge that cuts across all others is how Central Asia manages its increasingly scarce and critical water resources.

Realizing Vision 2050

In its journey from the current circumstances in the region to what is aspired to in Vision 2050, the region will have to complete four simultaneous transformations: from rural to urban societies; from resource based to diversified economies; from command and control economic management to market oriented systems; and from Soviet legacy institutions to those which are inclusive, transparent and accountable.

Achieving the aspirations embedded in Central Asia's Vision 2050 will need robust economic growth in the region. However, growth alone will not be enough. It needs to be inclusive, i.e., all members of the society must be able

3. Defined as GNI per capita—in current 2014 US\$—between \$1,045 and \$12,736.

4. Between \$1,045 to \$4,125.

5. Between \$ 4,126 and \$12,736.

6. The "neighborhood" is defined as including a broad swath of countries around Central Asia: Russia, the three South-Caucasus countries (Armenia, Azerbaijan, and Georgia), Turkey, Iran, Afghanistan, Pakistan, India, China, and Mongolia.

To meet the aspirations of Vision 2050, one of the most pressing challenge for the region is to achieve an “energy transition” to more sustainable policies and institutions.

to participate in and benefit from the process of growth. Growth also needs to be sustainable, both from environmental and institutional viewpoints.

To achieve these three complementary objectives—enhancing growth and productivity, encouraging inclusion and well being, and ensuring sustainability—policy makers need to focus especially on seven policy areas. There are obviously other important areas, but these seven will prove to be the most crucial in determining the future of the region.

Three of them are sectoral: energy, agriculture, and manufacturing and services. The other four policy areas are cross-sectoral and affect the economies as a whole: human development; climate change; regional cooperation; and institutions. Water management is an integral to these reforms.

Energy

Central Asia has substantial energy resources, though they are unevenly distributed across the region. Kazakhstan has oil (about 3.2 percent of the world’s proven oil reserves), Turkmenistan has gas (about 4.3 percent of the world’s proven gas reserves), and Uzbekistan has both, in limited quantities. Kyrgyzstan and Tajikistan have hydropower. The region, particularly in the steppes of Kazakhstan, also has significant (though as yet largely unrealized) potential in solar and wind energy.

While well-endowed with these energy resources, the region has exploited and used them in a highly inefficient manner, going back to the Soviet days marked by inappropriate policies, prices and institutions. To meet the aspirations of Vision 2050, one of the most pressing challenge for the region is to achieve an “energy transition” to more sustainable policies and institutions.

For all countries, continued energy price and subsidy reforms are the highest immediate priority. Full-cost recovery in the electricity and other energy sub sectors will generate much needed financial resources, induce energy efficiency, and ensure financial viability. Simultaneously,

however, targeted social protection will be necessary to cushion the vulnerable groups from the consequences of such reforms. More efficient use of energy—combined with generation of renewable energy—is a must for mitigation of global climate change.

In tandem, the Central Asian countries need to complete the transformation of the institutional framework by putting in place capable, agile and transparent regulatory institutions. The institutions will need to be independent of governments and vested interests, and be willing and able to react nimbly to the uncertain and rapidly changing global energy outlook.

Looking ahead to 2050, Central Asia would do well to consider new energy technologies, particularly in renewables. The world is moving decisively away from conventional fossil fuels (coal, oil, and biomass) into solar and wind power, areas in which Central Asia also has significant endowments. In Kazakhstan, Uzbekistan, and Turkmenistan, this is likely to include utility-scale solar power and wind power; in Kyrgyzstan and Tajikistan, this would include more small-scale hydropower as well as decentralized renewable electricity and heating solutions.

In parallel, Tajikistan and the Kyrgyz Republic should develop much more of their large hydropower potential to generate power for export (to neighboring countries and beyond, particularly to South Asia) and optimize the management of river flows. For this to happen, however, they would need to reach suitable and sustainable water sharing arrangements with the downstream countries (Kazakhstan, Turkmenistan, and Uzbekistan). Finally, Turkmenistan could develop large-scale natural gas trade with South and East Asia as well as with Europe.

In the long run, Central Asia could leverage its clean energy potential into a global climate change deal with the international community. This deal could unlock concessional financing for related investments as well as offer external guarantees.

Central Asia's agriculture will benefit from technological innovation and from an emerging middle class with its demands for more diversified higher-quality food.

Agriculture

Agriculture plays a critical role in the economies of Central Asia, accounting for about a quarter of the region's GDP and 45 percent of its total employment. Cotton and wheat are by far the most important crops in the region with the former being a particularly thirsty crop making significant demands on the region's water resources.

The sector faces several challenges, principally low productivity, low labor and water availability for cotton production, food insecurity, and competition in the global markets. In achieving the goals envisaged in Vision 2050, agriculture needs to transform itself into a modern and productive sector. This is essential for providing better paying jobs (essential for inclusive growth) as well as improving overall productivity.

Central Asia's agriculture will benefit from technological innovation and from an emerging middle class with its demands for more diversified higher-quality food. On the supply side, Central Asia's young and literate rural workforce would be more open to technological change and more willing and able to spot new opportunities within agribusiness or to moving out of agriculture to higher productivity work. Whether those positive developments do in fact occur will depend largely on the business environment in rural areas, which in turn will depend upon national policies.

In each country, a key shift would be to transform agricultural policy from control to facilitation. Appropriate market determined pricing of inputs (including labor) and outputs, easy access to agronomic and agricultural research knowledge, land tenure reforms, access to credit and adequate rural infrastructure would enable farmers to select and decide on the best agricultural practices in tune with their local conditions. This would be a far more efficient and effective practice than government directed actions in agriculture. Input and output prices should generally reflect true economic prices. Government intervention may be justified to correct market distortions, such as monopolies

in the agricultural supply chains or environmental impact, but it should be selective and non-discriminatory.

While Central Asia will gradually transform itself over the next several decades from a rural to an urban society, and its economic structure will diversify to include manufacturing and services, agriculture will still play an important role in the region. Enhancements in agricultural productivity will allow labor to be released to other sectors while maintaining the important contributions that agriculture makes to overall economic growth, to jobs in the rural areas, to the balance of payments and food security. Throughout the region, agriculture is expected to transform itself into a sector with more complex value chains and varied final products, making it less distinctive from other sectors in a modern industry and service economy. Overall, agriculture will remain crucial for promoting more inclusion.

Manufacturing and Services

Achieving the aspirations of Vision 2050 requires the development of a modern manufacturing sector integrated into Eurasian and global supply chains. It also requires a modern service sector that provides connectivity to other sectors through ICT, transport and logistics, offers effective business and financial services to the entire economy, and meets the growing and diversified needs of its population and international clients. Importantly, much of the requisite high productivity growth will have to be derived from the manufacturing and services sectors. Better paying jobs will also come from these two sectors.

The key factors that will determine Central Asia's ability to achieve this vision include the general, economy-wide factors such as the business climate, education and skills, connectivity, and strong macroeconomic and financial fundamentals. In addition, specific factors relevant for manufacturing and service sectors are urban and city development, innovation and targeted government support.

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concerted measures to improve the business climate is clearly an area of highest priority. For education, Kazakhstan has greater resources and capacity to forge ahead with ambitious plans than the other countries, although Uzbekistan has also stressed educational modernization, albeit with approaches that deserve to be revisited. All countries should systematically focus on connectivity, although again resource and capacity constraints may prevent some, such as Kyrgyzstan and Tajikistan, to aim as high as could their bigger and richer neighbors.

Each country faces somewhat different challenges in regard to financial sector development. Turkmenistan and Uzbekistan have yet to develop modern, market-based private financial institutions. Tajikistan needs to find ways to convert large remittances into financial assets in the banking sector to be deployed for productive investment, which in turn requires a trustworthy banking sector. Kyrgyzstan can build on its microcredit system and strengthen its financial sector more generally. Meanwhile, Kazakhstan has well developed banks, but needs to get their overhang of non-performing assets under control.

In regards to measures more specifically directed to support manufacturing and service activities, all countries need to focus on developing most efficient and smarter cities, again bearing in mind the limited resources and capacity that constrain the poorer countries. Smarter and greener cities are also essential for climate mitigation and adaptation.

Similarly, all countries can and should develop a view on how to encourage access to knowledge and technology of their firms, not least by expanding access to broadband technology. However, outright support for innovation should be selective and limited.

One of the options for faster progress towards the vision of Central Asia 2050 will be for some countries to lead the way and pull along their lagging neighbors as was the case in East and Southeast Asia's successful development over the last forty years.

Human Development

Central Asia needs an adequately educated, skilled, and healthy workforce to achieve the aspirations of Vision 2050. Education and health have a direct impact on productivity and well-being of the people. They also play an important facilitating role in enabling greater knowledge transfer, innovation, and adaptability of the countries in the region to the demands of competing in a knowledge-based globalized world. Finally, universal access to quality education and health care are absolutely essential to achieve the objective of more inclusive growth.

Central Asian countries started from a relatively high level of human capital at the time of independence. The situation worsened immediately after the breakup of the Soviet Union. But after experiencing initial losses, Central Asia has restored and even improved several dimensions of human development. Progress, however, has been uneven across the region, in part because of different initial conditions and in part because of different reform paths. Most human development indicators today largely reflect these differences in reform speed and depth.

Despite an undeniable commitment to education and health across the region and substantial reforms under way, the task ahead of improving human capital is immense. Central Asian countries still have a long way to go before they can fulfill their aspiration of having health and education outcomes close to those of developed countries. Persistent reform efforts and higher public and private investments will need to continue. An important aspect of such human development initiatives is that it must also be inclusive and equitably consider issues of access and coverage for all. Nevertheless, improvements that have occurred over the last decade are reasons to be hopeful about much faster progress and convergence among Central Asian countries.

Climate Change

Central Asia, like other emerging markets, cannot afford to ignore climate change. Their future prosperity and

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Climate change poses the main external challenge, for example, to the region's agriculture, with global warming and increased climatic volatility posing threats to some areas while possibly benefitting the colder areas of northern Kazakhstan

Given the emerging and future likely effects of climate change on Central Asian countries, strategies are needed to mitigate and adapt policy to climate change. The long-run extent of continued climate change will depend heavily on the success of mitigation efforts all over the world. Central Asia has a strong interest in promoting emissions reductions globally. Central Asian countries have, therefore, an important and self-interested role to play in the reduction of greenhouse gas emissions.

Strategically, the region's huge gas reserves and its large renewable energy resources (hydropower, solar, wind) could be harnessed to reduce the utilization of high carbon-emitting energy sources (particularly coal and oil) in neighboring China and in South Asia. This opens up an exciting possibility that Central Asia could play the role of a global citizen on the global climate change stage. Perhaps it could lead to a greater international support for Central Asia developing its water storage and associated hydropower in return for the region taking greater responsibility for climate change mitigation.

Integration with Global and Regional Markets

Central Asia faces huge opportunities due to its proximity to the buoyant markets of Asia, its location at the hub of a rapidly integrating Eurasian economic space, and the potential for greater intraregional integration. To exploit these opportunities, the countries need to overcome severe handicaps imposed by their own policy regimes

and inability to cooperate with each other. Their borders have become serious obstacles to transit and trade within the region, their behind-the-border business conditions are stifling private investment and trade, and their failure to cooperate in the management of regional water and energy resources has created severe economic, social, and environmental losses.

Continued cooperation of Central Asian economies with the rest of the world will enable them to reap additional benefits from the scale economies and other opportunities provided by larger world markets, global technology and knowhow, and worldwide best practices in trade, commerce, and finance. The unique geographic, demographic, and economic characteristics of Central Asian countries make it imperative to pursue efforts at greater regional cooperation.

Such efforts will need to be anchored on a strategy of "open regionalism"—an integration process in which the five Central Asian countries integrate with the global markets by seeking economic integration with their Eurasian neighbors (interregional integration) as well as among themselves (intraregional integration).

Their modest economic size and small populations imply that the benefits from intraregional integration alone will be somewhat limited unless they also forge stronger ties with the Eurasian neighbors especially Russia and Turkey on the northwest and the countries on the east and the southwest running all the way from China to Iran through India, Pakistan, Azerbaijan, and Afghanistan.

In a similar vein, their large and contiguous land area means that they cannot individually integrate well with their Eurasian neighbors because goods have to move across borders within the region to get to any of their Eurasian neighbors. Doing one without the other of these twin legs of regional cooperation and integration would have vastly diminished benefits for the countries.

Effective connectivity and integration of Central Asia's economy with its large neighbors in order to reach global markets combined with regional cooperation on trade,

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capital flows, and labor movements will be important ingredients in achieving the aspirations of Vision 2050. Central Asians have had a long tradition of openness and cooperation in the past and it is hoped that drawing on that history, greater cooperation and economic integration in the region will be possible.

Institutions

Despite substantial advances in the last 25 years, building modern governance and institutions in Central Asia is still work in progress. Assessing the current state of Central Asia's institutions from a broad governance perspective offers a mixed view. Over the last decade, a majority of countries in the region have improved their global rankings on three (of six) dimensions of governance: political stability, government effectiveness and regulatory quality. This is encouraging.

However, on three other dimensions: voice and accountability, rule of law, and corruption, their performance, as measured by global rankings (on the World Governance Indicators), has actually worsened. And yet, these are precisely the aspects of governance and institutional evolution that determine how any society measures up to their citizens' expectations and are key to enhanced, inclusive, and sustainable economic growth and well-being.

Perhaps the most important and most difficult challenge that Central Asia faces in aiming to achieve Vision 2050 is creating the essential governance and institutional conditions necessary for reaching sustained prosperity and high quality of life for the citizenry of the region. Since independence, the new Central Asian states have had to build market oriented institutions that are able to deal effectively with a rapidly changing global and regional geopolitical and economic system, dramatic changes in technology and market structures, and shifting values and aspirations of the citizens.

Post-independence experience of the five countries themselves and the lessons learned from elsewhere, particularly in Asia, suggest that the following five principles

are often a good guide going forward: tackle corruption aggressively, demonstrate that the rule of law applies to everyone, build an administration focused on delivering results, increase transparency, and recognize that political legitimacy built on trust is more sustainable than that built on fear. Also, currently, water usage in the Central Asian countries is generally inefficient, and lack of effective cooperation and trust among Central Asia countries has impeded optimal river basin-wide management of water resources. Climate change will likely exacerbate the challenges of water management.

Better water management requires action both at the national and regional levels. At the national level, each country will need to ensure that water is priced to appropriately reflect its scarcity value, and that adequate investments are made in water related infrastructure be it for storage, transmission and distribution of water and for the effective treatment of waste water. At the regional level, the countries need to cooperate and take a region wide view in developing upstream water storage and hydropower generation, and equitably share the benefits and costs.

Risks

The period covered by the vision—35 years—is long. The basic assumption behind the scenarios outlined here is that both the world and the region will remain peaceful, i.e., that there will be no catastrophic events (such as a nuclear war, massive natural disasters, or outbreaks of killer diseases) that will destroy the current global order. It further assumes that the sovereignty of current nation states in Central Asia will remain intact. Yet, short of such cataclysmic changes, Central Asian economies do face external and internal risks that could threaten the aspirational scenario.

In an increasingly interdependent global economy, there is always the risk of adverse development (a precipitous drop in commodity prices, another global financial crisis like in 2008, and/or a sharp and prolonged global recession) that could also have an adverse affect on Central Asia.

A major test will be the quality and credibility of future national leaders who will assume responsibility as a result of successions that will inevitably take place during the next 35 years.

As a defense against such risks, countries should redouble efforts to enhance their resilience against external shocks through adoption of prudent macroeconomic and trade policies and, most critically, develop stronger institutions responsible for national economic management.

A second major external risk concerns the political and religious environment in some of the neighboring countries. So far Central Asia has adroitly insulated itself from long standing civil strife and religious fundamentalism in the neighborhood. Over the short term, this will require constant vigilance. But over the longer term, the best defense will be implementation of more inclusive policies and giving people greater participation in political governance.

Undoubtedly, the biggest risk that could derail achievement of the aspirational vision relates to the ability of individual countries to successfully achieve the four transformations described earlier. There is no substitute to the commitment of the top leadership in each country to the long-term vision of economic, social and political development of the country. They must be willing and able to carry out reforms necessary to realize Vision 2050. In this context, a major test will be the quality and credibility of future national leaders who will assume responsibility as a result of successions that will inevitably take place during the next 35 years.

The Way Ahead

Meeting the above challenges to achieve Vision 2050 will undoubtedly be demanding as the above wide range of actions and reforms attest. Failure to meet these challenges could result in the countries in the region getting mired in a middle-income trap in which they would stop converging with today's developed economies. This will be costly for the region.

It is estimated that in such a downside scenario (dubbed the middle-income trap scenario), per capita income will grow by less than 2 percent a year and will be only around \$20,500 in 2050 or less than half of the aspirational scenario (2011 US dollars PPP). Given faster growth

in the rest of the world, Central Asia's per capita income will have fallen to about 60 percent of the world average from 75 percent today. Under such a scenario, the aspirations of a vast majority of Central Asians will remain unfulfilled, raising risks of social and political unrest.

Which of the two scenarios—the aspirational Vision 2050 or the middle-income trap—will come to pass will of course depend on many exogenous, external factors on which the Central Asian leaders and people will have little or no say. However, several important factors will be endogenous to the region and depend on the countries in the region, individually and collectively.

A major lesson from the “useable past” is that Central Asia thrived most when it was open to bold thought, tolerance, and a commitment to intellectual and religious pluralism. Thus, openness to the rest of the world and to each other in terms of trade, investment, and ideas is important for Central Asia to pursue.

Many of the policy and institutional reforms noted in here will take time to design and implement and the regional leaders, individually and collectively will need to pursue them with a sense of urgency to achieve the aspirational Vision 2050.

Doing so will not be easy. Difficult choices will have to be made and implemented with a sense of commitment and urgency.

If so done, Central Asia can achieve the bold aspirations embedded in Vision 2050.

