Session IV: Stabilization and Reform: Experience of Five Central Asian States

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<u>CONTENTS</u>

1. THE STRESSES OF STABILITY AND INSTABILITY

1.1 Stability under planned stress

As Union-Republics of the Soviet Union, the five Central Asian countries experienced many years of stable producer and consumer prices and of balanced budgets. Price-lists for transactions between state enterprises were changed at discrete but lengthy intervals (1949, 1952, 1955, 1967 and 1982) and for retail sales they moved both slowly and slightly (the index for 1988 was just 13 per cent above 1960). Although to take account of transport costs retail prices were broadly zoned, regional prices moved in the national pattern.[1] Union-Republican budgets were invariably balanced by adjusting to expenditure the share of revenue passed to the All-Union budget or by supplementation from the All-Union budget. Imports and exports were transacted at domestic prices by specialist foreign-trade agencies which absorbed price differentials. But all that stability was gained at the cost of efficiency, because price relativities failed adequately to reflect technical progress, consumer preferences and domestic and international competitiveness. The failure of price to equilibrate supply and demand (other than in kolkhoz markets and the informal economy) was a characteristic of the 'shortage economy', manifest in the household sector by a substantial 'inflationary overhang' which generated unofficial rationing, queueing, search costs and involuntary saving. The stability of the planned economy was bought at the cost of stress.

But that stress was also planned. Under repressed inflation households purchased the consumer goods and services that production plans made available or deferred consumption in the hope that product availablity would change: planners would examine the change in retail stocks to adjust the product-mix, but were under no obligation to match the indicated structure if other production priorities were greater. Producers were given 'taut' plans with the object of minimising input-output ratios (and releasing reserves hidden from planners) and were pressed further towards such goals by an annual decrease in the ratio at the margin (the 'ratchet principle'). Relatively egalitarian money incomes and implicit job security shifted negotiation for, and the attribution of, labour remuneration from the broadly overt to the broadly covert. These and many other characteristics of an 'administered economy' are worth recalling because at the time of systemic change administrators and administrated lost specified roles and the tensions associated with their execution, and had to find places in the evolution of market relationships. In the Central Asian context, an executive Presidency provided a continuity of political regulation to counterbalance the abrupt discontinuity of economic deregulation.

Government decision-makers were simultaneously creating new administrative institutions, such that nation-building took place at the same time and concerned much the same officials as did the radical adaptation of economic management.

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[1] Thus a statistical abstract devoted to retail trade gave many time-series for sales by Union-Republic, but prices were given only for the whole Union (*Torgovlya SSSR, statistichesky sbornik*, Goskomstat SSSR, 1989).

1.2 Instability under decontrol

Emergence into political independence released the tensions of the planned economy, but governments were challenged with new stresses of which five 'shocks' may be particularly distinguished. First, the Central Asian economies had been, on a world ranking, as much open to external trade in goods and services as their level of income indicated, and to capital and labour flows at the planners' discretion. But their trade and payments relations had been dominatingly operated from outside - by the planning and industrial agencies for the whole USSR in Moscow. Among the 'management shocks' at the micro level was theneed to evaluate comparative advantage with a new diversity of partners - how effective in import terms was, for example, the export of Kazakh copper or Uzbek cotton - and at the macro level how to control the transmission of external changes onto domestic activity. Secondly, the decision of the reformist Russian government to decontrol most retail and wholesale prices on 2 January 1992 had to be followed inside a rouble area that persisted until mid-1993 (and 1995 in Tajikistan). With a competitive market system scarcely established, a price-wage spiral (which had begun under the decontrols of *perestroika*) was quickly exacerbated under rigid supply-side conditions. Income and wealth distribution widened after wage controls were discarded (save for a brief reimposition in Uzbekistan) and before the application of much progressivity in personal taxation. Differentials became all the greater when advantage was taken of the widespread decontrol in the form of corruption, fraud and crime (and of hostilities in Tajikistan). Thirdly, that inflationary impetus was fuelled by rapid expansion of the money supply as governments resorted to monetizing fiscal deficits, occasioned by the withdrawal of the external transfers that were part of Soviet financial operation; by the restructuring of forms of tax and the tax base; and by temporarily greater spending requirements. There was an inevitable lag before a rudimentary domestic financial market and some access to external credit (initially from international agencies) and to the international financial markets (thus far tapped only in Kazakhstan) began to bring borrowing into the deficit framework. A fourth shock was recession: economic activity shrank as former 'planned' relations - internal and external - were liquidated more rapidly than their replacement by market linkages: the mix and level of demand underwent considerable change. Investment plummeted and the utilization of labour and of capacity significantly diminished. Fifthly there was a nationality shock. Some emigration of those of Slavic or German origin back to their homelands may have contributed to a sense of nation-building through greater ethnic homogeneity, but it contributed to productivity decline while sufficient skilled replacements were trained.

It is scarcely imaginable that the move from the stressful stability of the planned economy to the complex relationships of a market system could be implemented smoothly, even in the absence of human error and irrational action. Domestic transmission of the external shock (the sharp decline in FSU and CMEA demand) was rapid, because it came at a time when the planning mechanism, which under other circumstances could have absorbed acute changes, was being dismantled, and market relationships - unfamiliar to government and enterprise alike - were hesitantly being applied. First, even with central planning, the Union-Republican governments had not exercised control over all the enterprises and institutions on their territory: the Soviet lines of command ran straight to and from Moscow in the case of All-Union ministries, and authority was divided with Moscow in Union-

Republican ministries; at the sub-national level dual subordination was the rule, the duality being a ministry and the regional or local authority. Some budget-financed institutions were national, others - including military and space agencies[2] - were financed and administered from Moscow. Secondly, it had had few rights over its own finances, and such as it had by 1991 were newly won in what under perestroika had been termed 'the war of the laws'. Most tax rates were set by the Ministry of Finance in Moscow - some imposts were paid direct to it - and the Union-Republican and sub-national authorities had budgets which were balanced by the simple allowance to them of sufficient revenue to cover expenditure as established on centrally-determined norms. Where such allotted revenue did not equal outlay, payment was made from central funds, generating the financial transfers to which reference is made above. Thirdly, Central Asian officials (and academics who could be called on for advice) had had much fewer opportunities to study economic theory or practice in developed market economies; and their universities, still less their government departments, had but rare professional visitors from abroad.

The disequilibria induced by this transition must be examined to assess the instruments of stabilization and the institutional changes which have established viable market practices in the five states. These include new currencies, broad-scale privatization and the operational and legal infrastructure which transmits and responds to market-generated signals such as interest and exchange rates and securities prices. Open as these economies are, the export concentration effected under central planning on primary commodities (mainly metals and cotton) has continued in independence because these - especially newly-exploited hydrocarbons - offer current comparative trade advantage and attract foreign capital. But as dangers loom of the 'Dutch Disease' and over-reliance on a few price-sensitive commodities, diversification becomes more attractive.

2. MACROECONOMIC IMBALANCES

2.1 Capacity and demand in disequilibrium

Neither GDP nor any other single value can calibrate progress in systemic change, but aggregate supply and demand on the eve of transition offers a quantitative baseline for productive capacity and (somewhat roughly) for levels of living, the regaining of which signals the end of an abnormal period. There are many objections to GDP as a surrogate for welfare in the sense of outcomes of economic activity, but its estimation during a transition process may fail to measure a variant proportion of some comprehensive production aggregate than was the case in a planned economy. As already mentioned, newly-created businesses (some tempted to escape taxation or the law) are difficult for transition governments, themselves under change, to monitor. But there was similarly a 'shadow economy' under central planning as households and enterprise managers filled its interstices. The EBRD cites unpublished research which estimates the share of the unofficial

[2] After independence Russia recognised the Baikonur Space Centre as Kazakh state property but, after lengthy negotiations, leased it for a minimum of twenty years at an annual rental of $115 million, plus reimbursement of maintenance costs incurred by Kazakhstan in 1992 and 1993. Russia is, however, establishing its own space centre in its Far East.

economy in a GDP value aggregating 'official' and 'unofficial' production for 17 countries, of which two are Central Asian.[3] Whereas the unofficial sector in Kazakhstan [4]contributed more to that aggregate GDP in 1995 (34.3 per cent) than in 1989 (12.0 per cent), that in Uzbekistan contributed less (6.5 per cent in 1995 against 12.0 per cent in 1989). In this regard, Kazakhstan conformed to the trend of the majority, while Uzbekistan's decline was bracketed with Poland and Romania (shares were constant in Estonia and Slovakia but had been higher in intervening years). An estimate of the Kyrgyz Statistical Committee shows the unofficial sector as 16.5 per cent of the aggregate in 1994.[5] Subject to such caveat, official GDP in 1997 was (on ECE data[6]) more than 60 per cent of the 1989 level in Kazakhstan and the Kyrgyz Republic (all about the average for the CIS as a group), but much lower in Tajikistan, due to hostilities and economic disruption, and much higher in Turkmenistan and Uzbekistan (over 80 per cent of the 1989 level), where a modicum of price controls, state orders and protection from imports moderated the impact of structural change. A benchmark of established market economies may be taken from the European Commission's estimate of the European Union's unofficial sector in a combined aggregate GDP - about 10 per cent on average, with some countries close to 20 per cent.[7]

Other problems of mensuration, familiar from index number theory, reduce the effectiveness of GDP as an indicator of substantial production variation. The mix of goods and services provided under repressed inflation, arbitrary pricing and enterprise production-constraints must have differed greatly from that which were operating under market parameters. The composition and relative

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[3] EBRD *Transition Report 1997*, Box 4.2, citing S. Johnson, D. Kaufmann and A. Shleifer, 'Politics and Entrepreneurship in Transition Economies', William Davidson Institute Working Papers, no. 57, 1997, University of Michigan, and D. Kaufmann and A. Kaliberda, 'Integrating the Unofficial Economy into the Dynamics of Post-socialist Economies', Development Discussion Paper, no. 558, 1996, Harvard Institute for International Development.

[4] New estimates for Kazakhstan by the National Statistical Agency and by the Government's Centre for Economic Reform (staffed on EU-TACIS support) include the unofficial economy, but do not separately quantify it in the published versions (*Kazakstan Economic Trends*, First Quarter 1997, pp. 15-47.

[5] Cited by IMF Staff Country Report, *Kyrgyz Republic - Recent Economic Developments* (September 1996), p. 70.

[6] United Nations Economic Commission for Europe, *Economic Survey of Europe*, 1998, no. 1, Appendix Table B.1. The estimates diverge from corresponding estimates in EBRD, *Transition Report 1997*, Table 7.1 and is especially wide for Turkmenistan due to variant treatments of hydrocarbon pricing.

[7] As quoted in *Financial Times*, 9 April 1998 (percentages converted from the additions to official GDP cited); Belgium, Greece, Italy and Spain exhibited proportionately the highest 'unofficial' contributions.

valuation of demand and supply were profoundly affected by the government's predominance in procurement (of defence goods and services, farm produce and producer goods), its control over foreign trade and payments - all of which segregated a 'passive' form of money from that, in household and foreign hands, which had an 'active' role. Many goods and services, such as finance, the media and advertising, were either unprovided or supplied in a form which rapidly diversified as political and economic restrictions were lifted.

Production in mining and manufacturing has declined faster than GDP (and than in agriculture) in four Central Asian states, but in Uzbekistan industrial output has been above the 1989 level since 1994 (on ECE data). One reason is that trade with 'traditional' partners in temperate farm produce has held up more than for industrial materials and products (Kazakhstan, the Kyrgyz Republic and Turkmenistan) and 'non-traditional' partners have been found for cotton (Uzbekistan[8] and even war-damaged Tajikistan). The other is the deliberate protection of the existing agrarian institutions, with only nominal change in their membership, in contrast to the privatization and labour-shedding effected in industry. Services of all kinds were little favoured by Soviet planners and their opening up to private entrepreneurship (such as trade, catering and banking) and (still inadequately) to foreign providers (notably telecommunications) has made this general branch the most dynamic of the transition period. Kazakstan and Uzbekistan have notably shared in that dynamism. Finally, trends in construction have been conflicting: on the one hand civilian investment and military and security construction have respectively shrunk and all but disappeared, but on the other hand the privatization of housing and the widening of income differentials have fostered residential building and repair and more recently tourist and leisure facilities.

But the decline has been much steeper in consumer-good production in three states (Kazakhstan, the Kyrgyz Republic and Tajikistan) due to competition from imports. All post-communist countries, from the former GDR to Mongolia, experienced a buying-spree of Western goods for which household demand had been so long pent up. But it seems to have been longer lasting in Central Asia. In Uzbekistan the maintenance of an overvalued official exchange rate has favoured imports, but in all five countries 'shuttle trade' (not counted in registered trade) is predominantly of consumer goods. Available estimates of shuttle trade put it at an addition of $60-70 million to the Kyrgyz Republic's recorded imports of $894 million in 1996,[9] but as much as 'roughly half' of all imports (but 'almost negligible' for exports) for the same year in Kazakhstan.[10]

Demand-side conditions dominated the post-independence recession. The systemic shock - the loss of virtually guaranteed demand in the USSR and the rest of CMEA, the collapse of military purchasing, and the competition from imports arising from the dismantling of the state foreign trade

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[8] The cotton crop was however below average in Uzbekistan in both 1996 and 1997.

[9] IMF Staff Country Report, *Kyrgyz Republic - Recent Economic Developments* (January 1998), pp. 28 and 116.

[10] *Kazakstan Economic Trends,* Fourth Quarter 1996, p. 139.

monopoly - began at a first stage to be offset by larger state enterprises in opening up 'non-traditional' external markets and by the initiative of small and medium enterprises which were, in all five states, early objects of privatization. At a second stage, still in progress, dynamism was particularly due to the entry of foreign corporations as buyers at large privatizations or for joint ventures or direct investment (mainly in oil in Turkmenistan and Kazakhstan, gas and electricity in Kazakhstan, and manufacturing in Uzbekistan).

2.2 External disequilibria

Overall recovery may have been slower in Kazakhstan, the Kyrgyz Republic and Tajikistan (the countries with the still-deep recession) by the real appreciation of their new currencies, and accelerated in Turkmenistan and Uzbekistan (the countries with the least recession) by depreciation. In the three years to December 1997 the real value against the US dollar of the tenge rose 2.01 times, of the som 1.66 times and of the unit in Tajikistan 1.25 times (2.62 times from May 1995 when the Tajik rouble was introduced)[11].

The exchange rate has been influential on domestic output because the new states of 1991 inherited an open economy, even if it was strongly oriented to and from the Soviet republics and, to a much lesser extent, the then-disappearing CMEA, comprising East Europe, Cuba and Mongolia.[12] The Soviet expansion of trade with industrial market economies and with politically-selected developing countries brought by international *detente* had had little effect on Central Asia, despite exchanges with China and India. In 1988 total trade (imports plus exports) as a percentage of GDP was 34 in Kazakhstan, 39 in Turkmenistan and Uzbekistan, 42 in Tajikistan and 45 in the Kyrgyz Republic.[13] Such ratios are typical among 'middle-income' economies - 42 per cent on average for those thus classed by the World Bank - but, save for Kazakhstan, are higher than among 'low-income' countries - 35 per cent on World Bank statistics.[14] On per capita GNP (at actual exchange rates) the Bank puts Tajikistan and the Kyrgyz Republic within the 'lower incomes' ($340 and $700 respectively), and Turkmenistan, Uzbekistan, Kazakhstan the 'middle incomes' ($920, $970 and

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[11] IMF European II Department database.

[12] Cuban cane sugar displaced Kyrgyz sugar-beet and was imported as material for the republic's refineries. Mongolian copper and molybdenum were refined in Kazakhstan.

[13] IMF, *Economic Reviews: Common Issues and Interrepublic Relations in the Former USSR*, 1992, Table 1.

[14] World Bank, *World Development Report 1996: From Plan to Market*, aggregated GDP for 1994 from Table 12, aggregated imports and exports of merchandise from Table 15.

$1,330).[15] But of that 1988 trade turnover, between 86 and 89 per cent was with Soviet republics.[16]

Four Central Asian states ran import deficits (aggregating inter-republican and foreign trade) in 1988, amounting to $361 million for Kazakhstan, $60 million apiece for the Kyrgyz Republic and for Tajikistan, and $137 million for Uzbekistan; Turkmen trade was in equilibrium.[17]

As small open economies, the Central Asian states were sensitive to exogenous shock, but the shock at the time of their independence was the stronger because, as already mentioned, production and effective demand plummeted in the partner economies responsible for over four-fifths of their external trade. For three countries dependence on other Soviet republics became even greater in 1991 than it had been in 1988. The FSU share of total trade (imports plus exports) was 96 in Tajikistan, 91 in Kyrgyzstan and 89 in Kazakstan, and still high in the other two - 85 in Uzbekistan and 84 in Turkmenistan. It happened also that import demand was at the time weak in the few market economies with which Central Asia had trade relations.

2.3 Domestic disequilibria

The Soviet rouble circulated throughout Central Asia and Russia until mid-1993 and in January 1992 there were no constraints on trade among them. Russia's decontrol of most wholesale and retail prices on 2 January - decided the preceding November - had to be copied in the other republics, and by the end of that month all Central Asian governments had done likewise. Some limitations were retained on incomes (most of which had been state-determined in the past), but they largely followed prices in a familiar spiral. The degree of liberalization (and the subsequent reimposition of some controls) somewhat varied, but the measure was a profound shock. Enough has been written on the failure of the Russian government to limit price liberalization to the expected 'corrective inflation' for the explanations not to be reiterated here,[18] but two of the constituents must be noted as especially relevant to the Central Asian inflations. Competitive supplies, which in normal circumstances would have been attracted by the rapid price upswing and following money incomes,

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[15] The Bank (*World Development Report 1997: The State in a Changing World*, Table 1) cautions that these estimates are preliminary.

[16] The bounds were Kazakstan and Tajikistan at 86 per cent and Turkmenistan at 89 per cent (IMF, ibid.).

[17] *Narodnoe khozyaistvo SSSR v 1989g*, Goskomstat, Moscow, 1990, p. 639 at world prices in roubles (converted here at 18.3 to the $, as described in *Economic Survey of Europe*, 1998, no. 1, Table 4.2.4 and note 442).

[18] See *Economic Survey of Europe in 1992-1993*, pp. 160-8.

were still rarer in Central Asia than in Russia.[19] The contractual relationships between enterprises were abandoned and the republics' firms, nominally state-owned but effectively in the hands of 'insiders', exercised their monopoly power wherever they could; the low share of non-CIS trade made for few competitive imports. Secondly, the central banks of the five states, hastily redesignated from Union-Republican branches of the USSR Gosbank, could create rouble credits without hindrance, and even if they were to have exercised restraint, the lack or inadequacy of bankruptcy procedures or of branch-bank monitoring and sanctions allowed the accumulation of vast inter-enterprise indebtedness and tax arrears.

As in Russia and all CIS members, the liberalization shock conduced to rapid inflation, but to rates significantly less than in Russia. The exception was Kazakhstan where inflation was virtually identical to the Russian, probably because retail interchange was considerable between Southern Russia and the Slav-majority zones of northern Kazakhstan. By the imposition of price controls and a special purchase-constraining scheme for consumer goods, Uzbekistan had the lowest inflation,[20] in the initial 'shock' year, but it was just temporarily hidden. In annual terms, consumer-price inflation was in four digits for three years in Kazakstan and Turkmenistan, for two years in Uzbekistan, and for one year in Kyrgyzstan and Tajikistan.[21]

Until the establishment of separate currencies during 1993 (1995 in Tajikistan), rouble devaluation was a factor in these inflations, but a more potent force was monetization of fiscal deficits, which were in 1992 as per cent of GDP 31 in Tajikistan, 18 in Uzbekistan, 17 in the Kyrgyz Republic, 13 in Turkmenistan, but just 7 in Kazakhstan; there was a 13 per cent of GDP surplus in the Turkmen government accounts.[22] In the early years of independence, as already noted, that

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[19] So disrupted were intra-CIS trading relationships that a Czech firm found it profitable to purchase motor cars from the Volga Automobile Plant (VAZ) in Russia and a mere 220 km from the Kazakh frontier, have them transported to the Czech(oslovak) frontier and re-ship them forthwith to Kazakhstan. This particular commerce persisted until 1996.

[20]In addition to some rationing, coupons were issued with the wages and salaries of all state employees, cooperative members and social transferees equivalent to 70 per cent of the remuneration or benefit: these coupons had to be surrendered for purchases in state enterprises (except for newspapers, periodicals and books).

[21] The Tajik index does not cover regions (the majority of the territory) not ruled from Dushanbe, where some controls are enforced; it is likely that price increments have been higher elsewhere. At the time of the peace agreement of 23 December 1996, the Dushanbe and Kulyab regions were held by the government; Garm, north Komsomolabad and west Badakhshan were controlled by the Islamic and the democratic opposition; the rest of Badakhshan had its Ismaili separatists; and the remainder of the west and north was run by local clan chiefs (see map in *Central Asia Newsfile*, January 1997, p. 2).

[22] *Economic Survey of Europe in 1996-1997*, Table 4.2.1.

relatively high expenditure could not be covered by public borrowing, due to the absence of any domestic capital market and the inevitable delay before the international finance could be tapped. Soviet practice had drawn upon private savings only by commandeering funds from the amount due to depositors in the State Savings Bank; the new governments could at the time gain little from these banks when ownership passed to the republics, because the nominal value of deposits was soon greatly shrunk by rapid inflation.

Under these limitations, the five governments could pursue measures along three lines to moderate the extent of monetizing their fiscal deficits. First, until mid-1993 all but Kazakstan made heavy use of membership of the 'rouble zone' to issue credits on the Central Bank of Russia. Secondly, they strove to increase revenue, but were slowed by the need to reconstitute the fiscal system and to restructure the institutions for tax collection. Thirdly, they made efforts to constrain central and local expenditure, but the coincident impact of recession evoked further subsidies to state enterprises and the payment of more social benefits.

3. STABILIZATION POLICIES

3.1 Policies to increase revenue

Combined with the withdrawal of Union grants, Ministries of Finance were confronted with a profound real decline in revenue (receipts indexed by a GDP deflator) at a time when the profile of taxpayers and the composition of the tax base was in flux. First, large profits were generated in trade and currency dealing, little of which could initially be captured by taxation. A partial liberalization was undertaken of foreign exchange controls and of the quantitative restrictions imposed by central planning. 'Shuttle traders' doubtless finance some of their foreign purchases from 'flight funds' and duties at the frontier and tax on the proceeds are under-collected. Secondly, the recession particularly hit state enterprises, which proved less flexible to changing market conditions and more sensitive to ruptures of longstanding contracts with state firms elsewhere in the former Soviet Union. Because of previous close - often personal - relations with finance and industrial ministries, their managements were able to negotiate the tolerance, even the remission, of tax arrears. Thirdly, it became imperative to adjust forms of taxation from transfers of bank balances from one state account to another to the imposts more cost-effective and appropriate to a market system. A Soviet Ministry of Finance could levy turnover tax on a state enterprise, deduct its chosen share of profit, oversee the appropriation to investment or depreciation, deduct income tax at source (at a low non-progressive rate) and encash social security premia as a set proportion of the authorised wage-bill. Ministries of the independent states had no such automatic rights over state enterprises when they were corporatized[23] or privatized. Finally, the expansion of the private sector - *ab initio* as property rights were defined and protected, and from privatization - multiplied the number of potentially taxable enterprises and taxpayers. 'Small' privatization in all five states took precedence over that of medium and large firms, thereby substituting a myriad of taxpayers for a small number of groupings under administrations of

[23] That is, converted to joint-stock companies, wholly-owned by a state entity; state firms had already gained some financial autonomy under Soviet legislation after 1987.

the Ministry of Local Economy, of municipal and rural authorities or under state industrial and transport enterprises. Inadequate legal and law-enforcement infrastructures permitted an abnormal proportion of the new businesses to avoid tax payment or to conceal criminal activities.

Of the new range of taxes - the application of which involved a 'learning curve' - value-added tax (VAT) and personal income tax were the most pervasive. By 1995 VAT receipts constituted of total revenue (other than grants) 33 per cent in Kyrgyzstan and in Turkmenistan, 25 per cent in Tajikistan, 19 per cent in Uzbekistan, and 18 per cent in Kazakstan; individual income tax was 11 per cent in the Kyrgyz Republic, 9 per cent in Uzbekistan but only 6 per cent in Tajikistan and 3 per cent in Turkmenistan; returns for Kazakhstan consolidate enterprise and individual income taxes - in 1995 these were 34 per cent. Kyrgyz VAT legislation was amended with effect from 1 July 1996 to introduce a modern invoice-based tax based on the destination principle, to absorb the retail sales tax (inappropriately cumulated on VAT) and to conform to the requirements of the Customs Union with Belarus, Kazakhstan and Russia. The Tajik and Turkmen collection of personal income tax was low due to numerous exemptions which international advisers are seeking to eliminate, or at least to moderate.

3.2 Policies to reduce expenditure

As Soviet Union-Republics, the Central Asian states were remarkably homogeneous in the share of output commanded by direct state expenditure. Except for Tajikistan, there was at least one year of 1989-92 in which government expenditure was 31 or 32 per cent of GDP. Government absorption of a shrinking gross product has been reduced in four Central Asian states. Expenditure as a percentage of GDP in 1997 was 27.1 in both Kazakhstan and the Kyrgyz Republic, and 25.2 in Turkmenistan. Even after the cease-fires, government activity was much constrained in Tajikistan, where the percentage was 15.1. The Uzbek government on the other hand maintained, and in individual years has raised, its take of national resource-flows, which in 1997 was 33.0 per cent of a GDP only 14 per cent lower than in 1989. This policy followed from the major role attributed to the state in President Karimov's Basic Principles for 'Uzbekistan's Own Model for Transition to a Market Economy' - 'the state guarantees economic transformation'; 'social protection is a major function of the state'; and 'the consistent and phased implementation of economic reforms'.

A ready source of expenditure reduction was direct subsidies to state enterprises as privatization progressed, but some outlay persisted as subsidized credit on prolonged terms or by support from extrabudgetary funds. Although the vast majority of prices were decontrolled, where controls exist, some counterpart subsidization may be made[24] - municipal rents and services, and some public transport and communications in Kazakhstan; communal heating, electricity and imported grain in the Kyrgyz Republic; utilities, public transport and telecommunications in Tajikistan; and some municipal services and rents in Uzbekistan. Despite recent decontrols, the magnitude of subsidization

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[24] Thus any excess of an eligible household's outlay on rent and utilities which exceeds 30 per cent of that household's monthly income is paid from the Kazakh public funds (IMF Staff Country Report, *Kazakhstan - Recent Economic Developments,* August 1997, p. 46).

remains high in Turkmenistan and includes gratis utilities to most households, together with price controls on some basic foodstuffs, transport and communications and building materials.[25]

With the reduction in aggregate economic activity, social security spending was not susceptible of substantial reduction, especially for unemployment benefit, but scope has been found for a reduction in expenditure through the budget by transfer to extrabudgetary funds, and by better targeting. Thus when subsidies in the Kyrgyz Republic (which took as much as 5.5 per cent of GDP in 1993), were abolished in 1995 they were replaced by the so-called 'unified cash benefit' paid to households whose per capita income falls below a determined level - payment is triggered by three months below that level. By such targeting, the aggregate disbursement is expected to be much lower than was paid in subsidies.

3.3 The problem of arrears

Non-payment among public-sector entities, including state enterprises, was impossible under the Soviet system of automatic bank-account deduction as soon as a transaction was validated: they emerged as a massive issue after its abrogation and in the conditions which have prevailed before a framework of legal compliance is in place (notably on pledge, on bankruptcy and on the publication of accounts).[26] In the budget sector arrears among taxpayers reduce the funds available for collection, however high their legal priority - in this and in many other circumstances government agencies are deterred from enforcement by the impact of unemployment during the recession and by many other informal pressures from local authorities and the entities themselves. The authorities themselves allow arrears to mount in order to hold down expenditure in pursuit of macroeconomic stabilization: the problem of pension arrears became particularly acute in Kazakhstan in 1997 and in face of widespread public concern they were to be fully paid off and a new scheme, partially financed by private insurance, substituted.[27]
The central government in Kazakhstan had also cleared its wage and utility arrears by the end of 1996, but local governments were still in default: their arrears in wage payments equalled nearly one per cent of GDP and other arrears a further 1.5 per cent of GDP in 1997; enterprise debts payable in September 1997 totalled 1,101 billion tenge, the equivalent of 64 per cent of GDP (against 9 per cent in 1994).[28]

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[25] Detail in IMF Staff Country Report, *Republic of Turkmenistan - Recent Economic Developments,* October 1997, Table 5 (p. 104).

[26] See especially EBRD, *Transition Report 1997,* pp. 17-19.

[27] See 'Pension Reform in Kazakstan' and 'Are Funded Pensions Better than a Pay-As-You-Go System?', *Kazakhstan Economic Trends*, October-December 1997, pp. 17-52.

[28] IMF Staff Country Report, *Republic of Kazakhstan - Recent Economic Developments,* August 1997, p. 43; *Kazakhstan Economic Trends*, October-December 1997, p. 162, points out that financial stringency caused the government to suspend its survey of enterprise debt between June and

3.4 A more efficient structure of public finance and statistical monitoring

Tax collection became inevitably more costly as the tax base widened from a determinate set of state enterprises and trade agencies to a universe embracing a diverse private sector, potentially all the gainfully-employed and a ring of customs posts at land and air entry points. The inputs supplied included new legislation, the training of officials and physical structures. But it was of considerable importance to establish a self-standing agency of government to administer taxation and to separate tax-liable state entities from a 'cosy relationship'[29] with the Ministry of Finance and other supervisors. The diffusion of computerization in tax administration and expenditure monitoring and management, where it had been notably weak, was assisted by such concentration of work. More fundamental to proper financial management was the abrogation of earmarked taxes in a general conversion to a Treasury system for budget-financed departments and the establishment of self-funding executive agencies for such separable functions as health and unemployment insurance and social security. Supported by IMF missions, that fiscal concentration was achieved in the Kyrgyz Republic and in Turkmenistan in 1996, and began that year in Tajikistan and Uzbekistan for possible completion in 1998, and is complemented by the establishment of taxation agencies separate from the direct hierarchy of the Ministry of Finance.[30] Such agencies need staffing and of particular importance is the training and retraining of civil servants. The normalization of state financial services includes the extirpation of corrupt practice and of tax arrears and the transparency of public contracting.

The economic and business analysis of the Central Asian states has been hitherto complicated by gaps in national and sub-national statistics and by sometimes conflicting data as either reported by domestic agencies or reproduced by international organizations. Some of the problem lies in the difficulty of estimating magnitudes which involve tax avoidance, capital flight, illegal and corrupt transactions or trade in narcotics or arms. Another aspect is variant methodologies: everywhere national and enterprise accounting required transfer from Soviet to world-standard practices. At the macroeconomic level some specific developments may be noted - the thorough reworking of the

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December 1997, but a one-off survey in September showed enterprise arrears continuing to increase. The 1994 arrears exclude overdue loans to domestic banks (*IMF Economic Reviews: Kazakhstan*, no. 18, 1994, p. 24).

[29] The term is Janos Kornai's to describe the mutual interaction of a state enterprise, its supervisory agency and the Ministry of Finance in a Soviet-type system.

[30] IMF, Staff Country Reports: *Kyrgyz Republic: Recent Economic Developments*, January 1998, p. 19; *Republic of Uzbekistan - Recent Economic Developments,* October 1997, p. 36; *Turkmenistan - Recent Economic Developments,* July 1997, pp. 30-1; *Republic of Kazakhstan - Recent Economic Developments,* August 1997, p. 43 (which also notes than from 1998 all expenditures, some of which are financed from the private sector, related to the move of the capital to Almata in November 1997, would be incorporated in the budget in 1998).

national accounts of Kazakhstan onto an SNA basis,[31] and regular reporting and analysis of monetary aggregates.[32]

3.5 The establishment of new currencies

For the Central Asian governments at the moment of independence there were overwhelming advantages in the continued use of the Soviet rouble. The largest CIS economy outside Russia, Ukraine, broke away in 1992, but for the others a single rouble area was seen as a benefit to the maintenance (or restoration) of trade and payments relations within it; the newly-created central banks had no experience of monetary management, although the quarterly construction of 'the cash plan' by Union-Republican Ministries of Finance afforded a certain statistical expertise and network; and the EU's Maastricht Agreement was perceived as a model for the inheritance of a common currency which should not needlessly be dismantled. In pursuit of those expectations a group within the CIS - Armenia, Belarus, Kazakstan, Kyrgyzstan, Russia and Uzbekistan - meeting in Bishkek in October 1992 prepared for an Interstate Bank of the CIS, as had been delineated by a CIS Heads of State meeting in Tashkent the previous May. The IMF pointed out that those other banks had a reciprocal responsibility to establish uniform central bank lending rates and reserve requirements and to constrain their own credit issue, but monetary destabilization proceeded at widely disparate rates. Measured by rates of consumer-price inflation, changes had been remarkably uniform in 1992, as would be expected within a single currency area: the indexes deviated from the CIS average by little more than they had in 1991 (that is, prior to general price decontrol) - a coefficient of variation of 0.39 in 1992, against 0.35 in 1991. But in 1993 the spread was very much wider - that coefficient was 1.17 (and stayed high in 1994, at 0.93).

The Interstate Bank was never set up and the Central Bank of Russia (CBR) *de facto* assumed the role. It was patent that the CBR could not indefinitely tolerate credit issue outside its control. When in May 1993 it attempted to decelerate Russian inflation (with an exchange rate anchor), the IMF attached as conditions of a $1.5 billion Systemic Transformation Facility base rate and credit emission targets which would appreciate the real rate of exchange - the rouble-dollar rate was to be half that of domestic inflation. It consequentially required participation in the control of monetary issue of the CIS central banks using roubles (Azerbaijan, Belarus and Ukraine had quit in 1992). It emitted new Russian roubles in July 1993, quickly demonetizing Soviet roubles and allowing other CIS central banks to have these only upon its terms.[33]

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[31] *Kazakhstan Economic Trends*, First Quarter 1997, pp.15-47.

[32] Systematically in *Kazakhstan Economic Trends* and *Bulletin of the National Bank of the Kyrgyz Republic*; the former provides regular commentaries, as does *Bankovsky vestnik*, a collective publication of the Kyrgyz Central Bank and commercial banks.

[33] Among accounts of the break-up of the rouble area, see Anders Åslund, *How Russia Became a Market Economy*, Brookings Institution, Washington DC, 1995; Brigitte Granville, *The Success of Russian Economic Reforms*, Royal Institute of International Affairs, London, 1995; and

Of the Central Asian states, Tajikstan alone accepted, while the Kyrgyz Republic had already notified the other CIS governments earlier that year that it would introduce its own currency, and had in fact completed the operation by 21 May. The Kazakh, Turkmen and Uzbek authorities were thus committed to new monies, unless they accepted the stringent conditions of the RCB. The government of Kazakhstan, particularly in the light of the intense cross-border commercial relations with Russia, sought to retain the Russian rouble, but negotiations with Russia (through Vice-President Alexander Shokhin) broke down in late October on conditions for remaining on the rouble which included Russian custody of the Kazakh gold and currency reserve (then $222 million and $501 million), and payment of interest on rouble credits until the financial structure was aligned with the Russian.[34] On rejection of those terms, and in consultation with the IMF (which agreed a programme of economic reform and the lowering of trade barriers)[35] the manat was introduced in November. Uzbekistan introduced a transitional currency, the sum-coupon, in November 1993 without IMF support or advice. An informed observer, comparing its introduction with that of the Kyrgyz som, wrote that the Uzbek failure was attributable to 'the continued easy credit and monetary policies of the Central Bank'.[36]

To promote confidence in, and gain competitiveness for, the new currencies, the opportunity was taken to reduce the number of digits which inflation had added to currency units[37] and to devalue in the case of the Kazakh tenge and the Uzbek sum. But the Kyrgyz som maintained parity at the prevailing rate of the exchanged roubles and the Turkmen manat was actually made to appreciate. In the Kyrgyz Republic 200 Soviet roubles were exchanged for one som, except that deposits in the state Savings Bank (Sberbank) were recalculated at 150 to the som as a gesture towards those whose balances had previously been decimated by inflation. The government (supported by an IMF Stand-by Arrangement of $38 million) opted for full liberalization: all controls on current and capital transactions were lifted and the som was freely floated. The rate began to be set on an interbank market through twice-weekly foreign exchange auctions by the National Bank, and maintained within a narrow band to the dollar, mostly by varying the amounts of foreign exchange offered by the National Bank. Although there were periods of depreciation (early in 1994 and for much of 1995), the rate has shown a real appreciation as already noted.

Thomas D. Willett et al. (eds), *Establishing Monetary Stability in Emerging Market Economies*, Westview Press, Boulder, Colorado, 1995.

[34] *Central Asia Newsfile*, November 1993, p. 8.

[35] On the conversion and the programme, see *IMF Economic Reviews, Kazakhstan*, no. 18, 1994, pp. 21-4 and 33-4.

[36] Makkamjan Abdoulkadyrov, 'Monetary Reform: A Comparison of the Kyrgyz Republic and the Republic of Uzbekistan', *Comparative Economic Studies*, Vol. 37, No. 3 (Fall 1995), pp. 36-56.

[37] At the basic rates, the new units exchanged for 1,000 roubles in Uzbekistan (sum-coupon), 500 in Kazakstan (tenge) and Turkmenistan (manat) and for 200 roubles in Kyrgyzstan (som).

The introduction of the Kazak tenge was also accompanied by an IMF Stand-by Arrangement for $173 million. The conversion rate of 500 roubles to the tenge was applied to small sums in cash (up to 100,000 roubles per person, or roughly the average wage in October) and to personal bank deposits at 1 October. Larger sums in cash and later deposits were held in blocked accounts until their legitimacy as assets could be verified. Business balances were similarly capped and holdings above that cap were blocked for verification as to origin. All non-cash transactions had to be denominated in tenge, and, though foreign exchange could be used as cash, penalties were announced for refusal to accept tenge. A dual exchange rate was continued - an official and a commercial (plus, of course, an unofficial) - and from the introduction of the new units, weekly auctions of foreign currency were held and an interbank market was established for the tenge. Surrender requirements for encashment at the official rate were, however, enlarged: they had been at only 10 per cent of foreign exchange sold until shortly before the changeover and then were at 30 per cent, but at the start of 1994 the requirement was raised to 50 per cent. For its first two months the tenge maintained its real value, depreciation and inflation keeping pace, but it briefly depreciated in real terms in early 1994, before regaining its original level and, as already indicated, eventually showing a doubling in real terms against the dollar.

Article VIII commitment to the IMF (for full current account convertibility and non-discriminatory currency arrangements) was accepted by Kyrgyzstan in March 1995 and by Kazakhstan in July 1996.

Variant policies were pursued in Turkmenistan and Uzbekistan. When the Turkmen manat replaced the rouble in November 1993, two digits were cut off by exchanging 500 roubles for one manat and Savings Bank deposits of less than 10,000 roubles were set at 62.5 roubles for one manat as a gesture to the poorest hit by earlier inflation. But limits were imposed on the amounts that could be exchanged: no household could exchange more than stood to its members' credit at the Savings Bank on 1 September plus subsequent wage payments, and no individual could change more than 30,000 roubles. Exchange of business deposits were capped at 50 billion each plus 25 per cent of any higher balance. The remaining 75 per cent was frozen in state bonds for later redemption. A three-way multiple exchange rate was applied: the official rate which was used for all government transactions, a commercial rate for authorized private transactions and a special rate for gas transactions (which, however, operated only between April 1994 and February 1995). Due to limits on purchases of foreign currency ($1,000 per transaction) and a surrender requirement on certain sales, a parallel unofficial market persisted, at a severely devalued rate. For almost two years foreign currency could legally circulate side-by-side with the manat, but this was forbidden at the end of December 1995. Subsequently, the manat in real terms depreciated to a third of its introductory value in 1996, but by the end of 1997, had, as already stated, regained some strength and was 45 per cent of that value.

In Uzbekistan the dual exchange rate and foreign exchange surrender quotas at the official rate applied when the sum-coupon was introduced in November 1993, and when the interim currency depreciated and inflation accelerated discussions began with the IMF in February 1994. No agreement could be reached, and the sum-coupon was replaced in July 1994 by the sum on the basis of the government's judgement and reserves alone. The government had confidence in its ability to defend the new currency, having the right of preemption over the country's considerable gold production, having in 1993 been freed (like all CIS states except Russia) of any share of Soviet debt, and having run a visible surplus on merchandise trade in 1993.[38] To limit a wage spiral after such devaluation and expected price rises, a one-for-one tax was imposed (until end-1994) on any monthly wage-bill increment that exceeded 70 per cent of the enterprise's sales. The government's confidence extended to relaxing some current account exchange controls and to allowing virtually full exchange of sum-coupons, apart from a short freeze on bank deposits (that is, in contrast to the constraints imposed by the other Central Asian replacements of the previous year). It was misplaced, and within five months the sum was a mere fifth of its rate to the dollar. The devaluation took place at first cosmetically, by announcing a 'commercial' rate from 1 August and the next month unifying the official rate down to it (there was a spread between the rates between August 1995 and April 1996, after which the Central Bank supported the two together). Negotiations with the IMF were resumed and agreement was reached in January 1995. A Systemic Transformation Facility of $74 million was accorded against a budget cutting a disinflationary programme the deficit and inflation targets of which were not in the event met. But with IMF and other international support, exchange controls and tariffs were somewhat liberalized in July 1995, and the real exchange rate appreciated. Central bank auctions and an interbank market (paralleled by an unofficial market) brought a more ordered procedure, although various surrender quotas (for non-centralized exports, 15 per cent with CIS partners and 30 per cent with others) persisted. The market response to semi-liberalization was a modest real appreciation. In October 1996 the Central Bank of Uzbekistan realised that current income from cotton (about half total exports) would be much lower and that imports were running at about 50 per cent above 1995. The course advised by the National Bank for Foreign Economic Activities was devaluation - the prime cause of the import boom - but instead the Central Bank sold reserves and delayed exchange of sum into foreign currency, even for major investing firms such as Daewoo and BAT. In October, continuing to misjudge the situation, the Central Bank of Uzbekistan retroactively cancelled all 1,400 licences to buy foreign-exchange.[39] Reversing the partial current account liberalization, the measures prejudiced Uzbekistan's Article VIII commitment to the IMF during 1997. The Uzbek government, furthermore, imposed licensing for all imports. The IMF suspended disbursement of its Facility in December and a series of missions up to February/March 1997 declined to recommend resumption. For its part the government has been pursuing measures which suggest a readiness to dissociate itself from a positive relationship with the IMF in favour of a more protected industrial base which could gain comparative advantage within the Central Asian

[38] Aggregating CIS with rest of the world trade, the surplus was wholly derived from CIS partners and in 1994 was too small to offset the continuing visible deficit with the rest (IMF, Staff Country Report, *Uzbekistan - Selected Issues and Statistical Appendix*, August 1996, Tables 31 and 33).

[39] Accounts of the handling of the crisis include Michael Kaser, *The Economies of Kazakstan and Uzbekistan*, London, Royal Institute of International Affairs, 1997, pp. 30, 40-2; *Central Asia Newsfile*, October-November 1996, pp. 6-7; and Kasper Bartholdy, *Credit Suisse-First Boston, Emerging Economies Research - Europe*, 28 February 1997.

and nearby regions, partly on grounds of transport cost and its core of high-technology industries. Such a programme takes into account the country's lack of the huge hydrocarbon deposits possessed by its neighbours, and large prospective increments in its labour force for which to find employment. By the end of 1997 the unofficial rate of the sum to the dollar was about two-fifths in real terms of its level four years previously and, as stated above,the official rate was 82 per cent of its original dollar value.

Tajikistan was the exception to the exodus from the Soviet-period rouble in 1993, accepting the new Russian rouble. Civil war both within the country and in neighbouring Afghanistan rendered that part of the country under the administration of President Rakhmonov economically dependent on Russia and Uzbekistan. Economic weakness, and especially monetary instability, was unfavourable to the establishment of an autonomous currency. A dual currency emerged - cash was supplied by the Central Bank of Russia on commercial terms, but non-cash bank money could be created by the National Bank of Tajikistan without any constraint; the government needed funds to protect itself militarily and could raise few taxes in the disturbed social environment of the territory it nominally controlled. One of its financing sources was the sequestration of foreign exchange from the few earners of such - cotton plantations and the one aluminium plant, which staggered between idleness and polluting production. The foreign receipts were put into the extrabudgetary State Foreign Exchange Fund on the operation of which nothing was published, and some of the earnings passed to the owner at an unfavourable exchange rate. The government used the foreign exchange it thus seized to subsidize imports of grain and fuel, sold at low controlled prices to households. When the government in Dushanbe was reshaped in December 1994, an opportunity seemed to open for wider economic reform and an independent currency. From then until the changeover, in May 1995, a tight credit policy was pursued, although it was in part illusory because enterprises paid taxes in increasingly worthless bank money. Also, because cash was in short supply and many retail prices were controlled and subsidized, inflation was repressed: from 7,344 in 1993 and back to 2,132 in 1995, one version of the consumer price index rose just one per cent in 1994.[40] Due to the wedges that had opened up between the various forms of money, the rates of conversion were differentiated. Most non-cash money was converted at 1,000 roubles to one new Tajik rouble, but household and enterprise bank deposits were further disfavoured at 1,200 to one, except for the amount standing in credit to a household on 1 January 1993, which benefited from the same rate as cash, 100 to one. Public service wages (which had artfully been substantially increased on the eve of the reform), the minimum wage and social security payments were converted at the 100 rate. For many reasons - in which a rapid expansion of bank credit and the government’s failure to collect taxes or sufficiently to moderate subsidies played a large part - the economy and the new currency did not stabilize. In 1996 conditions began to return towards normality after the peace agreement, signed under UN mediation in Ashgabat in July, and seemingly more definitively settled (after a renewal of conflict) in December. Signs of increasing normality were the first EBRD involvement (incidentally making the

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[40] IMF Staff Country Report, *Republic of Tajikistan - Recent Economic Developments*, June 1996, Table 21 (variant data from this chapter's Table 4.2); its Table 21gives the wholesale price index at each end-year as 5,996 in 1993, 295 in 1994 and 628 in 1995. The above discussion draws on that Report, one of the very few sources on recent Tajik monetary and fiscal instability.

Bank active in all 26 of its countries of operation) and the opening of an Interbank Currency Exchange. Although the Tajik rouble has been allowed to float only for a short period it has appreciated against the dollar in real terms by about one-quarter.

3.6 The moderation of deficits and inflation

The monetary policies since 1993, the year when four new currencies were introduced**,** have reduced budget deficits in the Kyrgyz Republic (from 14.4 per cent of GDP to a still high 9.8 per cent in 1997), in Tajikistan (23.5 down to 3.7), and in Uzbekistan (10.4 to 2.8); they have remained small in Turkmenistan (0.5 up to 0.8) and have increased in Kazakhstan (1.4 to 3.7). Inflation in 1994 was still triple-digit in all five states, but by January 1998 the year-on-year CPI was down to below 20 per cent except in Tajikistan, where the disturbed state of the economy kept the rate as high as 152 per cent.

4. NSTITUTIONAL REFORM

4.1 Privatization

Essential as is state-enterprise divestment to the transformation of a former command economy, there is no ideal share which a private sector should bear in a market economy, save that it should be dominant. Central Asian governments have held on to state ownership for their relatively few large enterprises more than is the experience of most transition states, although, like the others, they have encouraged a private sector, both *ab initio* and by property transfer. EBRD estimates put the mid-1997 percentatge of GDP generated in the private sector at only 20 and 25 per cent in Tajikistan and Turkmenistan respectively, at 45 per cent in Uzbekistan and 55 and 60 per cent respectively in Kazakhstan and the Kyrgyz Republic.[41]

The annihilation of personal savings by the initial inflations excluded the public offering of shares on the UK privatization model, even if it had been seriously contemplated by the new governments of Central Asia. Just independent, they were wary of opening purchases indiscriminately to foreigners, although a few joint ventures with state enterprises were being accepted. They inherited a framework law from the USSR (on destatization and privatization of July 1991) which envisaged a voucher system through the allocation to citizens of dedicated savings accounts from which equity purchases could be made. Kazakhstan, the Kyrgyz Republic and Tajikistan followed that route with adaptations. Turkmenistan and Uzbekistan preferred a case-by-case procedure: the former has retained most large-scale enterprises in its own hands and substantially limited joint ventures with foreign concerns, while the latter has vigorously promoted foreign joint ventures.[42] No

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[41] EBRD, *Transition Report 1997*, Table 2.1.

[42] A detailed summary of privatization procedures forms an Appendix to Michael Kaser, 'Economic Transition in Six Central Asian Economies', *Central Asian Survey*, vol. 16, no. 1 (1977), pp. 5-26 (the 'sixth' economy in this case being Mongolia).

republic offered compensation or restitution to former owners, Soviet expropriation of non-farm businesses being too remote in time and too few to justify reopening the issue. All Central Asian governments have reserved certain enterprises for retention in the wholly-owned state sector, most extensively in Turkmenistan and Uzbekistan, and have favoured some management and employee participation in the medium and large enterprise sector. Small enterprises have been sold off, usually to staff, as also public housing, almost all to occupiers.

4.2 Agrarian reform

Soviet policy had resulted in the agriculture of four of the Central Asian states becoming concentrated in a mere 3,600 state and collective farms, with an average of 1,450 hectares sown area, against 14,000 farms before the Second World War, with an average of less than 400 hectares.[43] Agrarian reform, which in an optimal world might turn such vast collective and state farms coexisting with dwarfholdings of rural households into medium-size agri-businesses, has everywhere been slow and formal. The formal renunciation of collectivization was historically significant because of the coercion exercised by the Soviet authorities in the settlement of predominantly nomadic Kazakhs and Kyrgyz in the early 1930s, in the course of which one million died. The lost generation was replaced on state farms by deportees in Stalin's time (more into Kazakhstan than any other Union-Republic other than Russia) and by young Slav volunteers under Khrushchev's 'Virgin Lands Campaign'. Since independence collective farms in Kazakhstan have been restructured as joint-stock companies, 20 per cent of the shares being available for purchase by outsiders, provided they have experience of farming and are Kazakhstan citizens; employees of state farms (two-thirds of farmland) have been given long leases. The shares and leases may be sold and inherited, but - household plots and built-on land excepted - land remains formally in state ownership. In the Kyrgyz Republic, individuals could have their separate leases but most collective and state farmers agreed to reinstate their entities as cooperatives; all these leases are for 99 years, but freehold ownership is to be enacted. While land is still exclusively leasehold, Uzbekistan has broken up two-thirds of its collective farms into *dekhan* smallholdings, the remaining farmland being run as cooperatives. Tajikistan's *de facto* division has brought mixed experiences. In that part of the territory under control from Dushanbe, local authorities are authorized to lease land, all of which is vested in the state, for up to ten years, but less than ten per cent of farmland has been so taken over; however, it produces a third of agricutural output. In eastern Badakhshan peasant cooperatives have been established with financial and advisory support from the Aga Khan Foundation, as aid to those of the Ismaili sect of Islam. In Turkmenistan collective farms were dissolved in 1994 and the land was leased to members.

4.3 Regulatory functions and governance

The quantitative estimates of the EBRD secretariat on private-sector expansion already quoted include calibrations of transition to the market reached on regulatory or institutional criteria - enterprise governance, price liberalization, trade and foreign exchange system, competition policy;

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[43] ECE, *Economic Bulletin for Europe*, Vol. 9, No. 3, p. 55, for the states other than Kazakhstan.

banking reform and interest-rate liberalization; securities markets and non-bank financial institutions; and extensiveness and effectiveness of the relevant legal system Ranking is on a rising scale from 1 to 4 (with nuances of + and -). Kazakhstan, the Kyrgyz Republic and Uzbekistan ranked in mid-1997 2 or 3 on all measures, but Kazakhstan and the Kyrgyz Republic scored 4 for their trade and foreign exchange practices, on which Uzbekistan was ranked 2-. Tajikistan and Turkmenistan are uniformly lower - they showed four scores of the bottom 1, but enterprise governance was a 2- and price liberalization a 2 in Turkmenistan and price liberalization a 3- in Tajikistan. Legal reform was unmarked for Tajikistan and Turkmenistan.

4.4 Banking reform

It is characteristic of all five states that banking is dominated by state-owned institutions; that discriminatory restrictions are made on foreign banks; and that both co-exist with weak private-sector domestic banks. The World Bank early undertook an advisory role in the transformation of Union-Republican branches of Gosbank USSR into central banks, but of the commercial banks, many still state-owned, the IMF's observation of Kazakhstan applies generally: 'the weak financial position of major, formally fully state-owned banks, as well as the fragile position of newly emerging private banks...a large proportion of loans classified as uncollectable losses, although many of these were issued with government guarantees, insufficient capital to meet minimum international standards, poor or non-existent policies related to risk management, inadequate accounting and reporting systems, and excessive exposure to a few large borrowers.'[44] In Kazakhstan reserve requirements were increased in April 1995 and the regulatory role of the National Bank was strengthened by laws implemented by a decree of September 1995; the aggregate of foreign holdings in any bank must not exceed 30 per cent. Minimum reserve requirements have been applied in the Kyrgyz Republic to close a number of insolvent banks; foreign banks are allowed to operate under license. Higher reserve requirements were set by the National Bank of Tajikistan in January 1996, but the larger commercial banks are still majority state owned; up to 49 per cent foreign ownership in banks is allowed. The Central Bank of Turkmenistan supervises a rather weak commercial banking system, comprising seven fully- or largely-state-owned, two with minority state holdings and six private banks, two half foreign-owned. The regulatory function of the Central Bank of Uzbekistan was enhanced in December 1995, but the role of the National Bank for Foreign Economic Activities (the former Vneshekonbank of Soviet times) closely parallels it. With three other banks, state ownership controls 85 per cent of commercial banking assets, since the forty or so private banks are small.[45]

4.5 Conclusions

Each President has formulated an economic and social strategy for his country and each has a mandate by election or referendum to hold office until the eve of, or into, the next millennium. President Akar Akaev has promulgated a ‘Strategy of Social and Economic Development of the

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[44] IMF, *Kazakstan - Recent Economic Developments*, March 1996, p. 38.

[45] Information from EBRD *Transition Report 1997*, 'Transition indicators for each country.'

Kyrgyz Republic to the Year 2005'.[46] It is posited on a general economic expansion - a doubling of real GDP between 1995 and 2005 (about 7 per cent annually) - and requires completion of land reform and of industrial restructuring, special concern for small and medium enterprises, the development of an appropriate financial infrastructure and the attraction of FDI. For Uzbekistan, President Islam Karimov among systemic objectives has stressed 'the shaping of market relations and the formation of a class of owners', but warns against 'blind, thoughtless copying of useless schemes and models of market transformations'.[47] President Nursultan Nazarbayev had a multi-ethnic state in mind in evoking 'the development of democracy, property rights reform and the movement towards a full-fledged market system' as 'conducive to the rise of a nation state'.[48] President Saparmurat Niyazov has colourfully evoked a future for Turkmenistan as 'the Kuwait of the Karakum'[49] and has set sights less on his northern than on his southern and western neighbours. Finally, the Tajik Parliament adopted in November 1995 a reform programme to the year 2000, which promises the liberalization of foreign trade (except for retention of the aluminium and cotton state monopsony), further privatization and the achievement of an open and transparent economy with favourable conditions for foreign investment and promoting exports.

The combination foreseen for four of the states is of strong presidential authority with the encouragement of markets by and large divided between small and medium domestic entrepreneurs and for bigger manufacturing and resource development joint ventures with transnational corporations. Unification is only slowly coming to Tajikistan, dependent as much on events outside its frontiers as on national accord. The present political stability characterizing the four presidentially-centralized states has now been complemented by the basic framework of market institutions and a monetary stabilization and a production upturn that could scarcely have been foreseen in the aftermath of independence.

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[46] Summarized in the President's address to the World Economic Forum, Davos, February 1997, *Kyrgyzstan: Signs of Recovery*, mimeo.

[47] Islam Karimov, *Uzbekistan on the Threshold of the Twenty-First Century*, Curzon, London, 1997, p. 117.

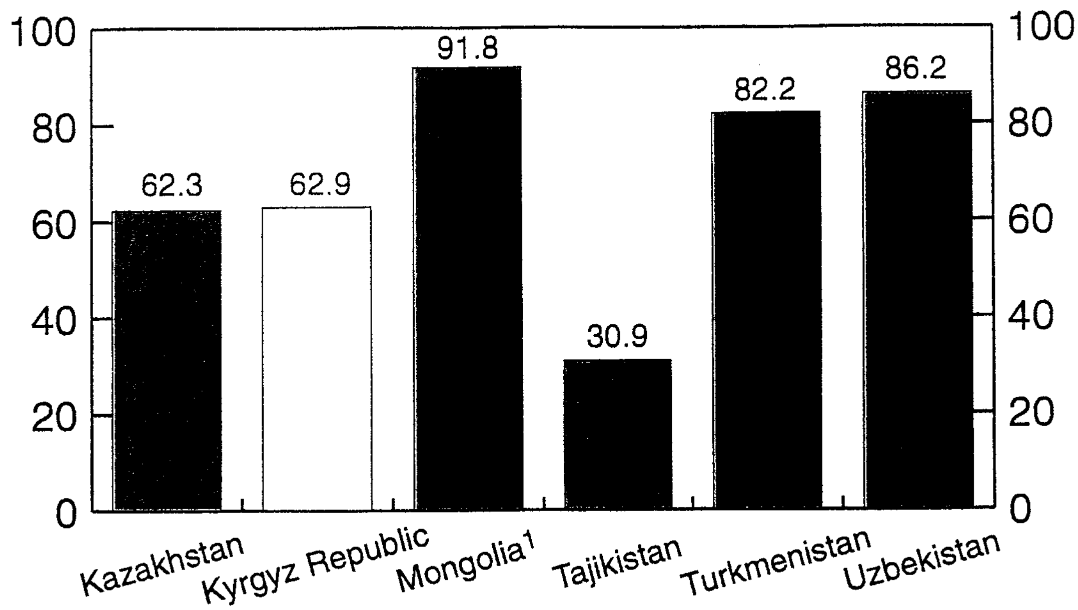
[48] Nursultan Nazarbayev, *A Strategy for the Development of Kazakstan as a Nation State*, Kazakstan Embassy, Washington DC, 1994.

[49] Cited in *Central Asian Newsfile*, November 1993, p. 6.

Graph 1a

Gross Domestic Product

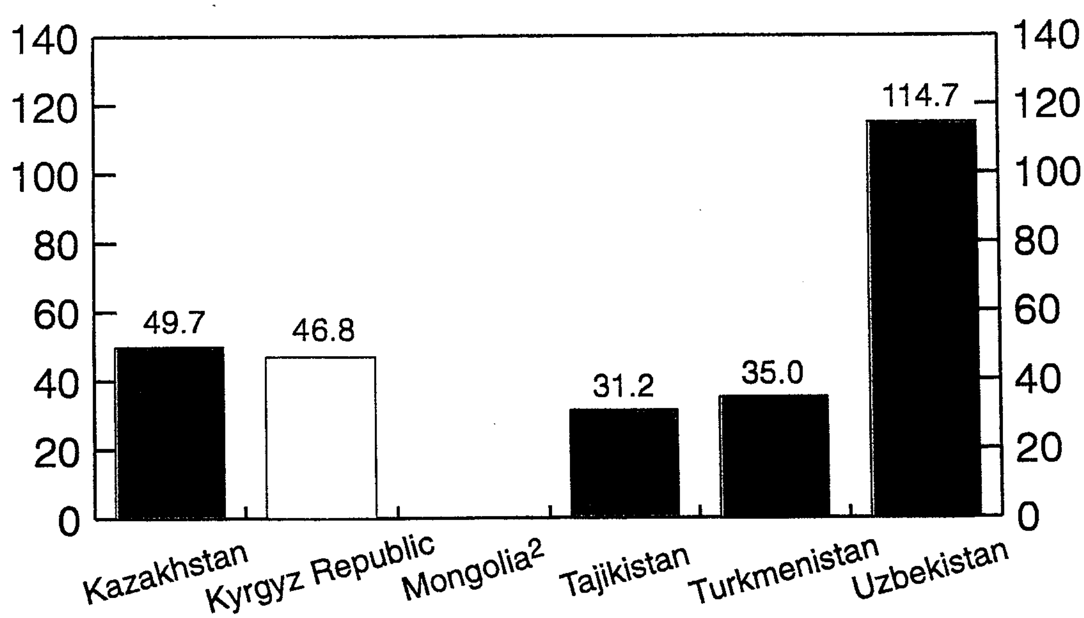
(1997 as percent of 1989)



Graph 1b

Industrial Output

(1997 as percent of 1989)



Source: IMF.

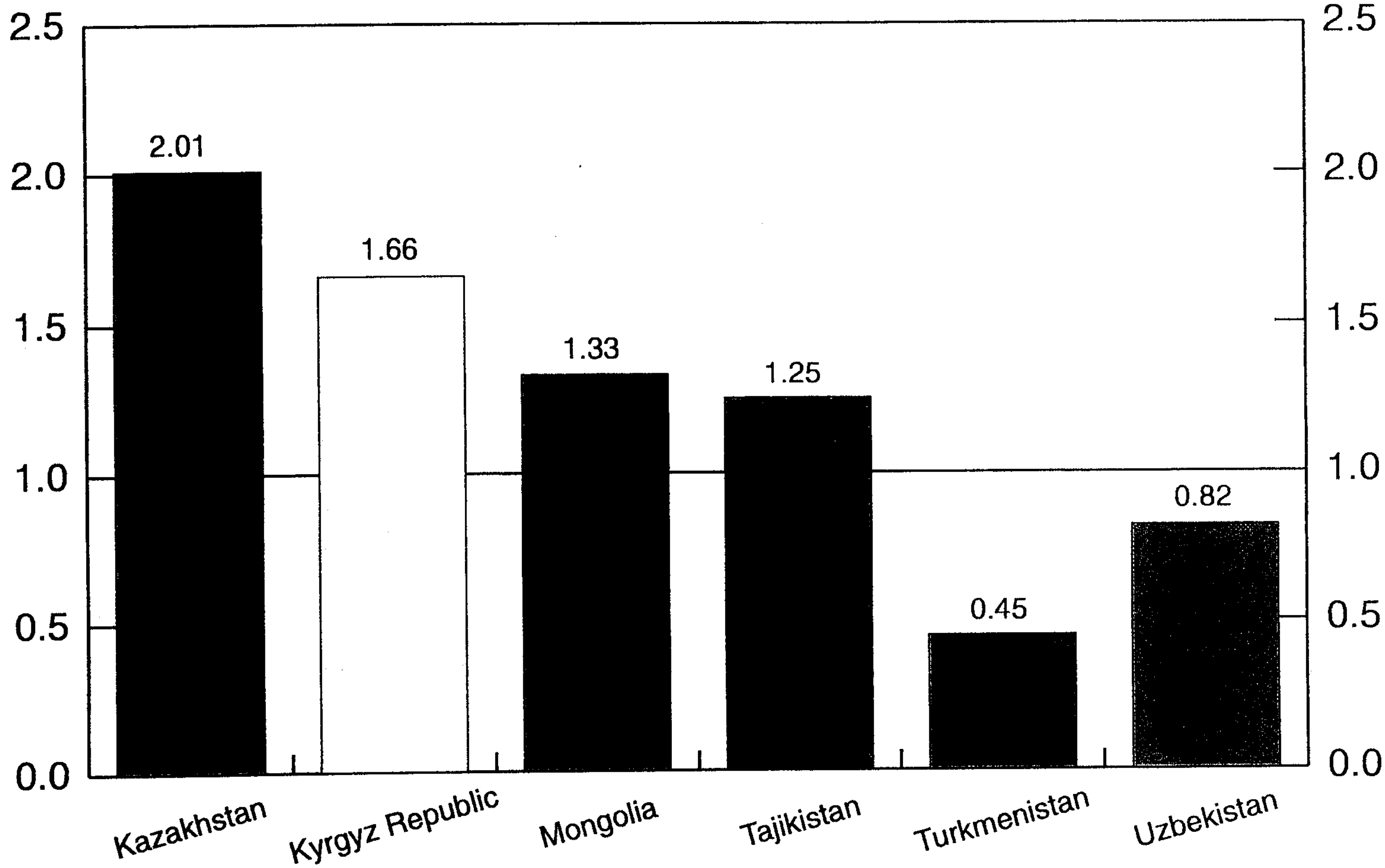
[1] 1997/1990.

[2] 1997 data not available.

Graph 2

Real exchange rate

(Dec. 1997/Dec. 1993)

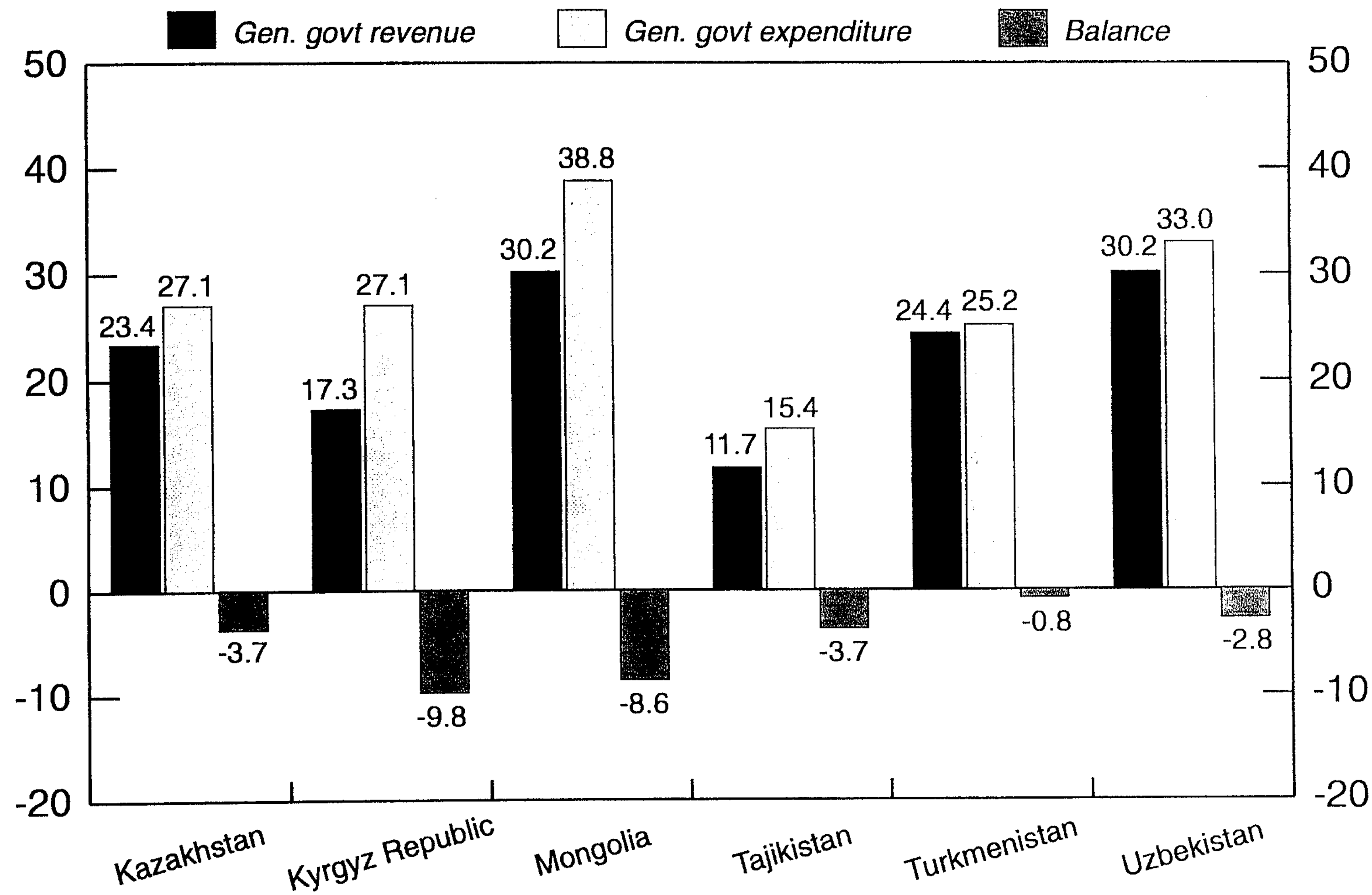


Source: IMF.

Graph 3

Government Revenue and Expenditure

(Percent of 1997 GDP)

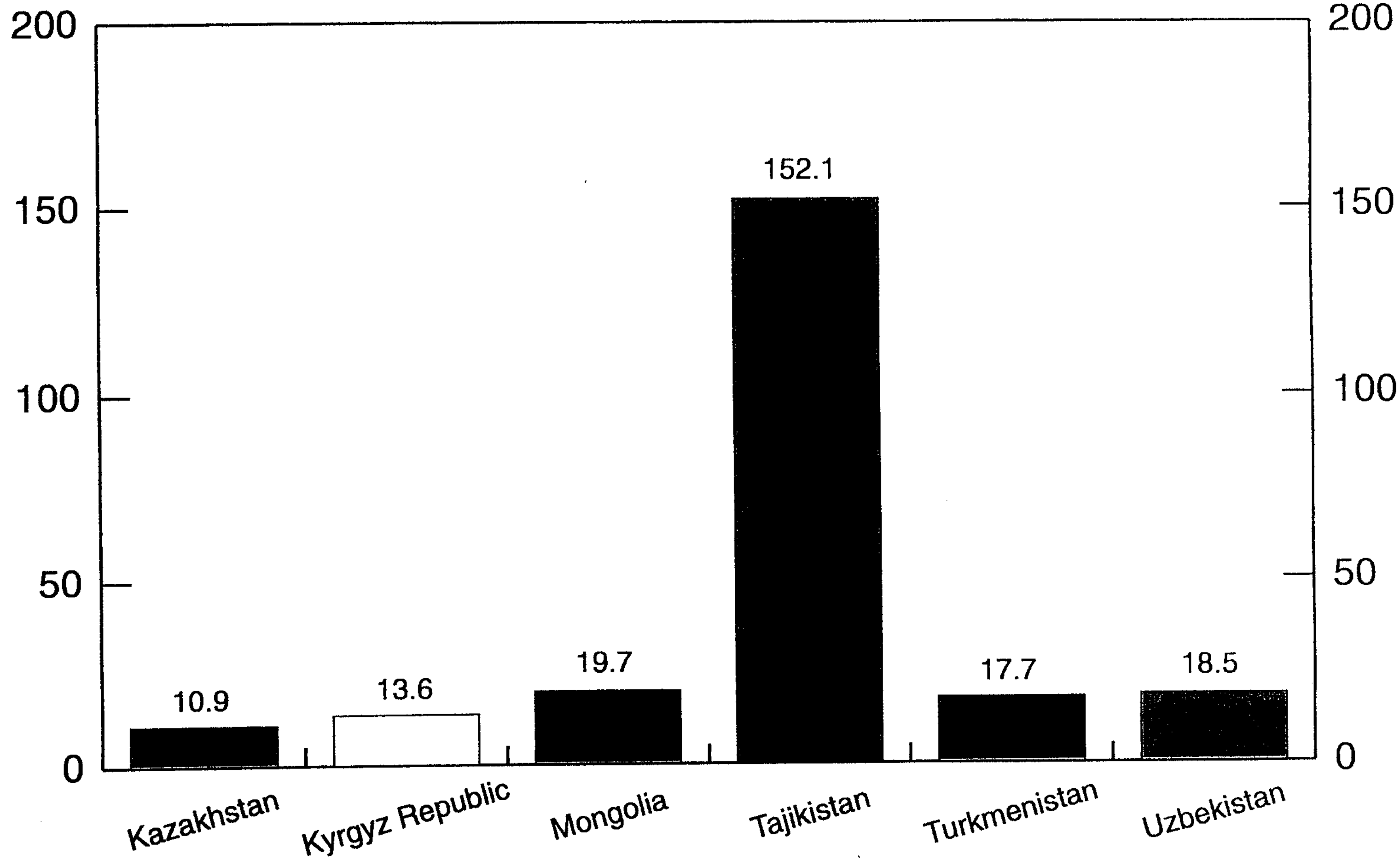


Source: IMF.

Graph 4

Consumer Price Index - January 1998

(Year-on year percentages)



Source: IMF.

Figure 1

Transition Progress

	1	2	3	4	5	6	7
Kazakhstan	2	3	4	2	2+	2	2
Kyrgyz Republic	2	3	4	2	3–	2	2
Tajikistan	1	3–	2	1	1	1	–
Turkmenistan	2–	2	1	1	1	1	–
Uzbekistan	2	3–	2–	2	2–	2–	2

Source: EBRD, *Transition Rèport 1997*, pp. 14, 17.
[1]Enterprise governance.
[2]Price liberalization.
[3]Trade and forex system.
[4]Competition policy.
[5]Banking reform.
[6]Securities market.
[7]Legal system.