



Eurasian
Development Bank

The Economy of Central Asia: A Fresh Perspective



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A FRESH PERSPECTIVE ON THE ECONOMY OF CENTRAL ASIA

Central Asia — five republics in the centre of the Eurasian space



Central Asia — large and dynamically developing region

- ▶ Substantial progress in social and economic development
- ▶ Capacious sales market and expanding pool of labour resources
- ▶ Improving living standards
- ▶ Dynamic development of infrastructure and increasing mobility of the population
- ▶ Strategic role of the region in Eurasia: substantial growth prospects

The region's achievements and structural changes

Increase in 2000–2021

		2000	2010	2021
 1.4x	Population, millions	55	62	77
 7.5x	GDP, \$ billions	46	243	347
 1.8x	Share in global GDP (PPP), %	0.4	0.6	0.7
 17.2x	FDI stock, \$ billions	12.3	101.6	211.4
 6x	Turnover of foreign trade in goods, \$ billions	27.4	149.4	165.5
 3.1x	Mobility of the population, pkm/person	2,198	4,435	6,792 (2019)

↑ from 6.4% to 9.9%

increase in the share of mutual trade in goods among Central Asian countries in total foreign trade turnover over the last eight years

6.2%

average annual GDP growth rate in the Central Asian countries over the last 20 years

2x

FDI stock originating from the PRC exceeds FDI stock originating from the RF

\$52.8 billion

estimated aggregate value of proposed investment projects in the region's water and energy complex in 2021

Challenges

Lack of access to the sea

- ▶ Excessive transport costs
- ▶ Constrained growth of trade

Resource dependence and low level of financial development

- ▶ GDP growth volatility
- ▶ Constrained growth of household incomes

Lack of coordination in the water and energy complex

- ▶ Economic losses
- ▶ Increasing water shortage

Climate change and environmental damage

- ▶ Rising temperature
- ▶ Pollution of the biosphere

Region's growth points

Development of transit transport potential, creation of the Eurasian transport network

Attraction of private investment, diversification of production and exports, expansion of the range of financial services

Coordinated development of the water and energy complex

"Green" transformation of the economies

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The economic role and prospects of Central Asia are still not fully appreciated by the world. Over the last 20 years, the countries of the region have made significant progress in their development, and have far-reaching growth prospects. The region's GDP has been increasing at an average rate of 6.2% per year in real terms, reaching \$347 billion. The population of Central Asia is almost 77 million, and it keeps growing at the rate of 2% per year. Inward FDI stock is estimated at \$211 billion, with foreign trade turnover having increased sixfold since 2000. However, because of inertia, the international community still fails to perceive the region as a major player on the economic map of the world. The purpose of this report is to offer a fresh perspective on Central Asia as a large and dynamic region. The report provides an analysis of economic development outcomes for the countries of the region, an assessment of their successes and challenges, and defines points of further economic growth. The strategic role of Central Asia in the vast Eurasian space will be increasing: the region will become more important for its immediate neighbours, and for its key economic partners – Russia and China. The countries of the region received an historic chance to take advantage of their transit position, and of the opportunity to expand into external markets through emerging international transport corridors. A significant potential is offered by coordinated development of the water and energy complex, including “green” power engineering. To unlock the region's potential, it is important to overcome certain other challenges, such as the lack of access to the sea, resource dependence, low level of financial development, and impact of climate change.

Keywords: Central Asia, Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan, Turkmenistan, Eurasian Economic Union, mutual trade, mutual investments, regional cooperation, economic development.

JEL: E60, F13, F15, F21, F43, F50, F64, O13, Q57.

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SUMMARY

The economic role and prospects of Central Asia are still not fully appreciated by the world. Largely because of inertia, the international community still fails to perceive the region as a major player on the economic map of the world. However, the region is changing, and its role needs to be reassessed. Over the last 20 years, the countries of Central Asia have made significant progress in their development. The share of Central Asia in global GDP (PPP) has increased by a factor of 1.8 since 2000 (see Figure A). Its countries have established themselves economically, and have far-reaching growth prospects. The purpose of this report is to offer **a fresh perspective on Central Asia** as a large and dynamically developing region.

Central Asia had an aggregate GDP of \$347 billion in 2021. Over the last two decades, the GDP of Central Asia grew more than sevenfold (see Figure B) — fourfold in real terms. Inward FDI stock is estimated at \$211 billion, with foreign trade turnover having increased sixfold since 2000. Dynamic economic growth is the result of structural economic transformations in the 1990s, and favourable conditions in global commodity markets.

The region's growing population provides a capacious sales market, and generates an expanding pool of labour resources. The region's population of 77 million keeps growing at the rate of almost 2% per year. Over the last 20 years, it increased at an average annual rate of 1.6%. The region's population has increased by a factor of 1.4 since 2000. According to UN estimates, the average annual population growth rate in the region is projected at 1.1% until 2040. Demographics definitely favour economic growth in Central Asia. The current age distribution points to a future growth of labour resources.

↓ Figure A. The Region's Achievements and Structural Changes

Increase in 2000–2021	2000	2010	2021
 1.4x Population, millions	55	62	77
 7.5x GDP, \$ billions	46	243	347
 1.8x Share in global GDP (PPP), %	0.4	0.6	0.7
 17.2x FDI stock, \$ billions	12.3	101.6	211.4
 6x Turnover of foreign trade in goods, \$ billions	27.4	149.4	165.5
 3.1x Mobility of the population, pkm/person	2,198	4,435	6,792 (2019)

Source: EDB analysis based on national statistical agencies, central (national) banks, IMF, ADB, WB, Trade Map, CEIC.

The average annual economic growth rate in Central Asian countries over the last 20 years is 6.2%. During the same period, emerging countries and the world as a whole reported annual growth rates of 5.3% and 2.6%, respectively (see Figure C). Growth of export revenues, remittances by migrant workers, and foreign direct investment contributed to the rise of incomes and reduction of poverty.

That dynamic economic growth has facilitated a trend toward **convergence of income levels** in Central Asia with those of **developed countries**. In Kazakhstan, the GDP per capita (PPP)

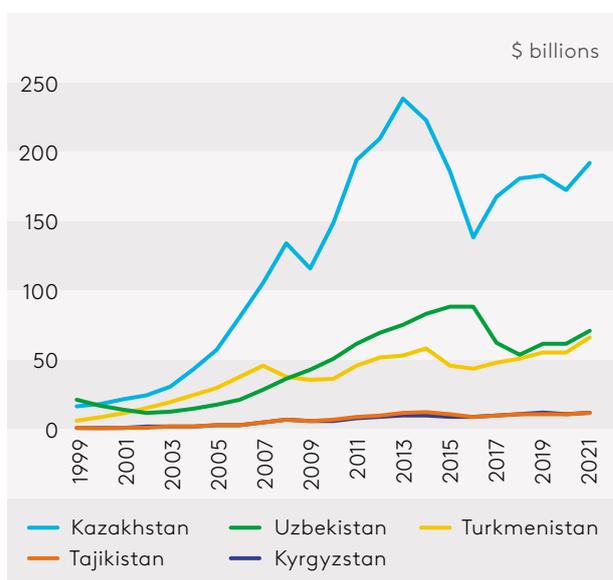
stands at half of that of developed countries, in Turkmenistan at one third, while the gap between the other Central Asian countries and developed economies is even wider, ranging from 7 to 14 times. Over the last 20 years, the situation has greatly improved. In most countries of the region, per capita GDP (PPP) increased threefold.

The strategies of the Central Asian countries rely on **taking advantage of the benefits offered by globalisation and regional economic integration**. Globalisation benefits are related to the international division of labour and the favourable geographic position of the region between China, Russia, and Turkey. Other critical factors include the strengthening of China, and involvement of Central Asian countries in the Belt and Road Initiative.

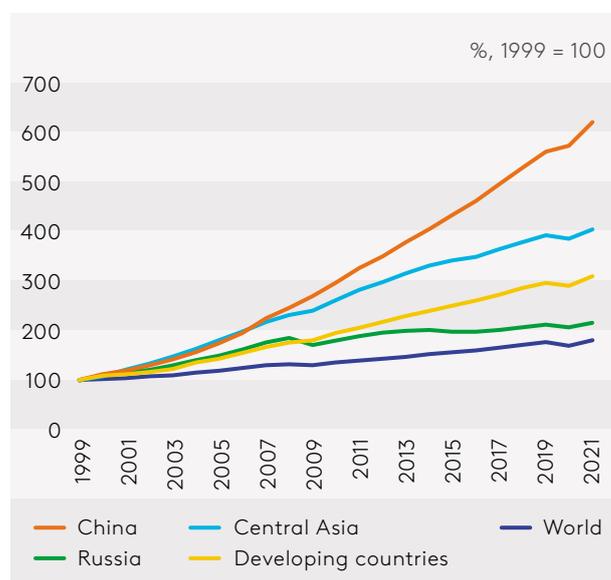
The **isolationist policies (including economic policy)** that some countries have been pursuing over the last several decades have **exhausted themselves**. Central Asian countries are trying to find their place in the world economy. Transformation of economic strategy in Uzbekistan is a good example. Turkmenistan is demonstrating increasing openness, stepping up its efforts to promote foreign investment and expanding its presence in large international and regional projects.

In 2021, the turnover of foreign trade in goods of the Central Asian countries reached \$165.5 billion, a sixfold increase over the last 20 years. The fact that Central Asian countries lie at the intersection of transport corridors creates opportunities for expanding their transit potential in terms of both transportation of goods and incorporation in cross-border production chains. The role of Asian states in the foreign trade of the Central Asian countries is increasing. The list of Russia’s trade competitors in the region now includes not only the PRC, but also Turkey, India, and South Korea. In addition, mutual trade among the countries of the region is developing at a faster rate than their foreign trade outside the region.

↓ Figure B. GDP of the Central Asian Countries



↓ Figure C. Real GDP



Source: EDB calculations based on IMF data.

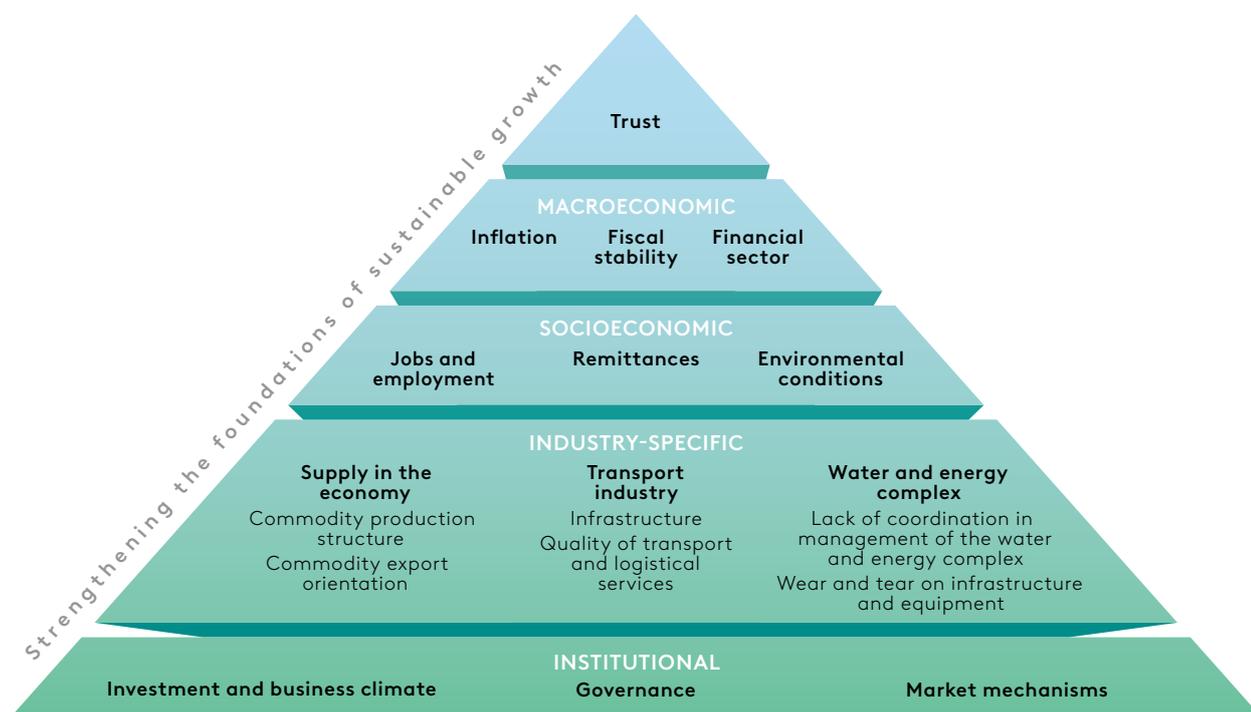
Inward FDI stock of Central Asia is estimated at \$211 billion. Over the last 20 years, that indicator has increased more than 17-fold. Despite the positive rate of growth of FDI in the region, its breakdown by countries and sectors remains rather distinctive. The fact that some countries of the region were closed to the world for a protracted period of time, as well as their remoteness from the main economic centres, lack of access to the sea, and proximity to Afghanistan, still have a negative effect on how the region is perceived by investors. The

share of FDI in the GDP is higher than the global average (2021: 61% vs. 47%), but lower when measured net of investments in the commodity sectors (Abdymomunova et al., 2018), which points to an overall **underinvestment** in the region.

Total private investment by the PRC in the region stands at about \$40 billion, which is about twice as much as that invested by Russia. Massive inflow of funding from China opens up new opportunities for the region, but it also creates long-term risks. Sustainable development of the Central Asian countries will be linked to a balanced approach to attracting external financial resources through strengthening and development of good-neighbourly relations within the other countries of the region, and implementation of regional programmes by international organisations and development banks. To ensure sustainable development, it will be necessary to attract FDI in non-commodity sectors, and use the potential offered by domestic saving.

The share of mutual trade between Central Asian countries in their total trade turnover is consistently increasing, having reached 9.9% by the end of 2021. Uzbekistan provided a powerful impetus to development and expansion of intra-regional trade after 2017. The bulk of trade in the Central Asian countries is linked to Kazakhstan, whose share in total mutual trade in the region is 80.9%. The rate of development of regional trade affects investment cooperation. Priority areas of economic cooperation among the countries of the region are infrastructural development and industrial cooperation. Intra-regional cooperation will help to boost industrial production and improve the food security of the region.

↓ Figure D. Constraining Factors and Conditions of Economic Development in Central Asia



Source: EDB.

Despite certain progress, there are **several systemic problems constraining** social and economic development of the Central Asian countries (see Figure D). The economic boom related to the rise in commodity prices was not used by them in full. Commodity exports and remittances by migrant workers still play a disproportionate role in the economies of the region. Other significant issues include the quality of the institutional environment, underdevelopment of regional transport networks, lack of coordination in management of the water and energy complex, low level of development of the financial sector, social problems, macroeconomic risks, and insufficient harmonisation of regional trade and

economic relations. Removal of structural development constraints remains a challenge for the Central Asian countries.

The factors listed above may become major **risks for the future economic development** of the Central Asian countries. If the landlocked Central Asian countries fail to create effective freight transit systems, they will fall behind countries that have access to the sea by 20% on the average (UN, 2014), and fail to be fully integrated into the world market. It is necessary to expand and improve the road and railway infrastructure, and to harmonise and simplify border crossing procedures. Another major risk is the increasing load on water resources. This global challenge is particularly dangerous for the Central Asian region, as its countries are heavily dependent on agricultural production and vulnerable to the climate-related problems caused by drying up of bodies of water and melting glaciers.

Working together, the Central Asian countries will be better equipped to overcome structural development issues. Because of the increased load on their energy systems due to active economic growth, and because of their connection through shared river basins, cooperation among the Central Asian countries in the water and energy complex has no alternative. Joint actions to improve the transport infrastructure and combat climate-related risks are equally important.

Eliminating bottlenecks in the **infrastructural sectors (transport, the water and energy complex) will make it possible to improve productivity of the economy**, expand trade and economic partnership with the neighbouring countries, and increase product diversification of production and exports. Improving the complementarity of the commodity structures of production will strengthen mutually beneficial cooperation among Central Asian countries and reduce their vulnerability to external shocks. Improvement of the institutional environment will enable an acceleration of structural economic transformation in the region.

The inadequate level of cooperation in the water and energy complex inflicts economic damage from year to year. The unrealised benefits are estimated at 0.6% of the region's aggregate GDP in agriculture, and 0.9% in the energy complex. The structure of the investment portfolio is far from optimal, as it fails to account for regional interests. Total investment proposals related to Central Asia's water and energy complex are estimated at \$52.8 billion, with the bulk of investment capital going to the generation segment. At the same time, water infrastructure facilities have used up their service lives and require upgrades and modernisation. The Central Asian countries have abundant energy resources and a high RES potential. Implementation of energy projects, including "green" power engineering projects, will make it possible to improve the energy mix and, at a later stage, export electricity.

Central Asia is characterised by **rapid development of transport infrastructure and increasing population mobility**. Efforts in that area have been hugely successful — the total length of railways and paved roads is growing; there are numerous new Caspian seaports, airports, transport and logistics centres, and border crossing points. Over the last several years, there has been a rapid increase in the volume of container transit using both the conventional route (China–Kazakhstan–Russia–EU) and the Trans-Caspian International Transport Route. New railway routes and container services will ensure a more effective integration in global supply chains. Considerable progress was achieved in improvement of road safety. During the period from 2000 to 2019, before the pandemic, transport mobility of the population more than tripled.

The Eurasian transport network should become the solution that will enable landlocked Central Asian countries to connect to each other and to their foreign trading partners. The network is already in place, and work is under way to improve its individual elements. It will be transformed into a network of routes that will join various international transport corridors traversing Central Asia, and contribute to the creation of new container services

and logistical chains. It will enable establishment of stable and safe transport and economic ties, and reduce transport costs incurred by Central Asia economies.

Central Asia is among the regions that are most vulnerable to climate change. Food supplies, water, and energy resources are particularly sensitive to climate challenges. Besides, climate change poses the problem of conservation of biodiversity for the countries of the region. Environmental problems degrade living conditions, inhibit economic development, primarily in agriculture, and diminish the investment and tourist appeal of the region. **“Green” transformation of the region’s economies is a necessity.** The region needs investment in low-carbon technologies and “green” projects, including RES, power- and resource-saving technologies, modernisation of the water and energy complex, land development projects, desertification control, and reforestation.

The opportunities opening before the countries of the region acquire special significance in the new geopolitical environment. Following a policy of openness, mutually beneficial cooperation and coordination of efforts will enable Central Asian countries to achieve a qualitative breakthrough in their development. Vulnerability to external factors can be reduced by fostering internal growth drivers. The countries of the region need to overcome four key structural challenges: lack of access to the sea, resource dependence and the low level of development of the financial sector, lack of coordination in management of the water and energy complex, climate change (see Figure E). Solving these problems will most effectively unlock the region’s economic potential. It is equally important to make use of the opportunities emerging in the global economy and to attract and adapt global technologies, in particular, digital and “green” technologies.

Structural challenges are primarily linked to infrastructural development. Infrastructure projects are highly capital intensive. The Central Asian countries need to modernize existing and create new infrastructure, and in these conditions an integration-based development path is the optimal solution. Geographic proximity creates conditions conducive to infrastructural integration. For example, the fact that West Africa has a shared power grid enables smaller countries to benefit from the economies of scale and risk-mitigating advantages of large power networks (Devarajan, 2017). The World Bank assesses the economic benefits received by the regional power market in West Africa due to lower production costs at \$5–8 billion per year (World Bank, 2018).

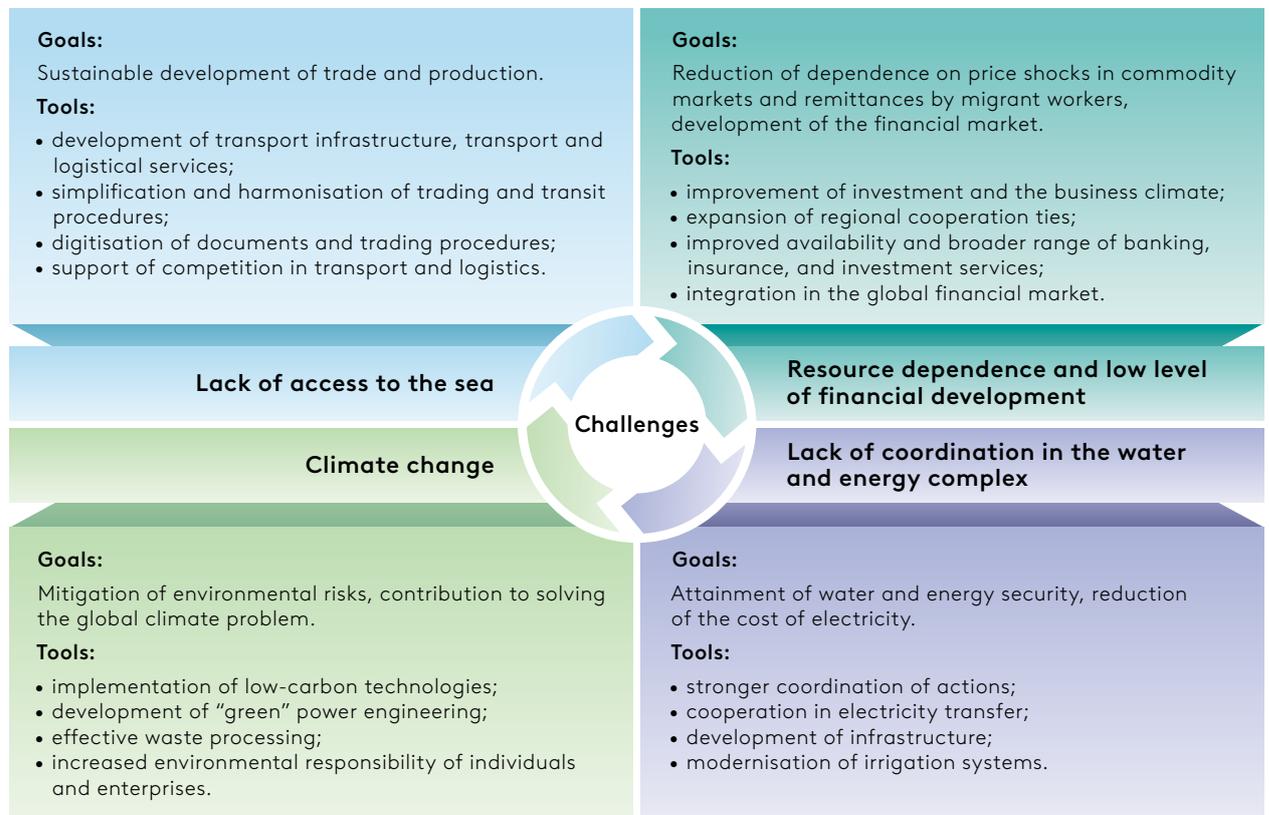
Coordinated development of the infrastructure makes it possible to maximize effects and save on costs. According to World Bank estimates based on infrastructural development indicators of African countries, investing in roads greatly influences sectoral changes, encouraging workers to move from agriculture (a low-productivity sector) to the manufacturing industry and services. Concurrent investment in roads and electricity increases the overall impact by a factor of 2.5 (Herrera Dappe, Lebrand, 2021).

The EAEU is the preferred format for expansion of economic integration of Central Asian countries. EAEU membership creates a single regulatory environment, provides access to an extensive common market for labour, capital, and services, eliminates barriers to mutual trade, and promotes industrial cooperation.

The strategic role of Central Asia on the economic map of the world will be increasing, particularly for Russia and China. Central Asia ceases to be the hinterlands relative to the large economic players in the vast Eurasian space. Transformation of the region largely depends on internal efforts, private investment, and large-scale multilateral programmes. Central Asia may become a financially stable and dynamically developing region of Greater Eurasia, employing effective regional cooperation mechanisms, and being actively involved in the operation of the value chains built by national businesses offering competitive goods and services to both domestic and foreign consumers. The emergence of Central Asia as a

flourishing region will facilitate resolution of other sensitive geopolitical issues in this part of the continent, in particular, by enabling involvement of Afghanistan in economic relations with the neighbouring countries.

↓ Figure E. Structural Challenges and Mitigation Tools



Source: EDB.