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4-4-2005

## Economic Integration in Central Asia

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### Recommended Citation

Eshniyazaov, Rustam and Van der Sluis, Evert, "Economic Integration in Central Asia" (2005). *Economics Commentator*. Paper 452.  
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# ECONOMICS COMMENTATOR

South Dakota State University

No. 461

April 4, 2005



## Economic Integration in Central Asia

by  
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Following the success of the European Union (EU) and other economic blocs, many countries have sought to further their economic growth by integrating their economies with those of other nations. In this *Commentator* we provide a brief overview of efforts among five nations in the southern part of the Former Soviet Union (FSU) to form an economic bloc. The five nations are referred to here as “Central Asia”, and include Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan (Figure 1). After providing background information about the region and describing the transition process following the collapse of the Soviet Union, we explain efforts among the five nations to increase mutual international economic cooperation and assess its economic implications.

Figure 1. Map of Central Asia



## Background

The five nations of Central Asia span a vast territory of approximately 1.5 million square miles, or about half the total size of the contiguous 48 U.S. states. The region is inhabited by 58 million people, about half of whom are of working age. Life expectancy in the region is between 66 and 69 years, the adult literacy rate is 99%, and annual GDP per capita varies from \$1,000 in Tajikistan to \$6,300 in Kazakhstan.

Central Asia contains a vast amount of natural resources. Together, the five nations hold 10.1 billion barrels of oil and 233.0 trillion cubic feet of natural gas, or 0.9% and 3.7% of the world’s total proven reserves, respectively. The region has rich natural deposits of precious metals such as gold and silver, and vast reserves of coal, iron ore, chromites, zinc, copper, titanium, bauxite and uranium. In particular, Kazakhstan has the world’s largest reserves of tungsten, and the second largest reserves of chromites and phosphorous. Further, Uzbekistan has the world’s fourth largest reserves of gold, and is currently the ninth largest producer of this metal.

The ample supply of natural resources provides an abundance of inputs in the production of intermediate products made in the region such as steel, aluminum, cement, chemicals, construction materials, and electric motors. Final products include tractors and other agricultural machinery, refrigerators, automobiles and even airplanes.

In spite of its wealth of natural resources, the region relies heavily on agricultural production and processing industries. Although climate and weather conditions allow for the production of a broad range of agricultural products, such as fruits, vegetables, tobacco,

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livestock, and wool, the economies in the region remain foremost dependent upon a very small number of agricultural commodities, notably wheat, cotton, barley, maize and rice (Table 1). As a result of Soviet planning, the largely arid region is a major producer of cotton and rice, both of which require large amounts of water. The region produces 6.7% and 0.1% of global cotton and rice output, respectively. In fact, Uzbekistan is the second largest exporter of cotton in the world, after the United States.

**Table 1. Central Asia's production, export and imports of cotton and grains in 2003 (in mmt\*)**

	Production	Exports	Imports
Wheat	20	5.9	0.2
Cotton	3.4	2.4	0
Barley	2.6	0.6	0
Maize	1.07	0	0
Rice	0.7	0	0.03

\*mmt = million metric tons

### The Economic Transition of the 1990s

The collapse of the Soviet Union also brought an end to centrally planned markets that relied on an artificial balance between product supply and demand within the FSU. After achieving independence, each FSU nation was forced to develop its own domestic markets and earn foreign currency by exporting agricultural products. However, the Central Asian nations had difficulty competing in global commodity markets, mainly because their land-locked locations forced them to transport their products destined for export through economically and politically unstable neighboring nations, resulting in high transportation costs and thus high product prices.

Since the collapse of the Soviet Union the five nations have experienced a number of related difficulties, including ecological problems associated with the over-use of water for cash crop production and the associated desertification of the region, pollution flowing into the ever decreasing Aral sea bordering Kazakhstan and Uzbekistan, environmental problems as a result of nuclear waste from decades of bomb experiments in Semipalatinsk, Kazakhstan, and difficulties with chemical and biological waste inherited from years of experiments on Bozrojdnie Island in the Aral sea. Economic progress was further

hampered as a result of the 1992-1997 civil war in Tajikistan, narcotics traffic from Afghanistan to Russia and Europe, and dangers associated with Islamic fundamentalist groups. Consequently, the transition to market-based economic systems has been very difficult and led to a severe economic downturn in the mid-1990s.

Currently, after almost 14 years of independence and a process of economic reforms including the development of institutions for facilitating market-based systems, the economies of Central Asia are slowly improving. Nevertheless, economic activity in the region remains well below levels achieved before the transition from a centrally-planned to a market-based system starting in 1991 (Table 2). For example, wheat production in Kazakhstan fell from 18.2 mmt to 4.7 mmt between 1992 and 1998, but partially rebounded to 10.2 mmt in 2004.

**Table 2. GDP per capital in Central Asia.**

Country	Year of highest value of GDP	Highest value of GDP per capita	GDP per capita in 2003
Kazakhstan	1989	\$7,948	\$6,300
Kyrgyzstan	1990	\$4,392	\$1,600
Tajikistan	1988	\$3,731	\$1,000
Turkmenistan	1988	\$7,626	\$5,800
Uzbekistan	1989	\$2,950	\$1,700

### Motives for Regional Cooperation

In general, economic integration among two or more sovereign nations may increase their economic growth if they agree to decrease their trade barriers with one another. Over time, increased international integration may also enable firms to extend their markets abroad, and may lead to efficiency improvements and economies of scale. As a result, consumers may benefit from decreased product prices, potentially freeing up funds for economic investment and stimulating long term economic growth. For example, economic estimates have shown that member countries of the EU achieved

considerable economic growth due to their increased economic integration.

Notwithstanding the fact that there may also be economic losses associated with increased international economic integration and non-member countries often incur damages as a result of the formation of such trade blocs, in recent years many nations have tried to integrate their economies with those of other, often surrounding nations. The cooperating nations may be loosely organized by way of preferential trade arrangements or free trade agreements, or become further integrated by forming customs unions or even common markets.

Since the five Central Asian nations achieved independence in 1991, their leaders have slowly come to realize that regional cooperation is vital for future economic development. There are several grounds for moving towards increased international economic integration in the region. First, the five nations have similar historic, ethnic, and cultural roots. With the exception of Tajikistan, whose language is Persian-based, all languages spoken in the region are Turkish-based and are similar. In addition, almost all people in the region are able to speak Russian.

A second reason for seeking economic integration is that without international cooperation no country in the region will be able to solve its own ecological difficulties. Because the nations bear a collective responsibility for facing water shortages and pollution, alleviation of these problems can only be achieved by way of commonly agreed-upon actions. Third, because natural and human resources are unequally distributed across the region, their efficient and sustainable use can only be achieved by way of joint efforts by the nations in the region. Fourth, because all five nations are land-locked, exporting and importing must take place in agreement with neighboring nations. These and other reasons, such as maintaining peace and fighting terrorism, provide ample motives for the Central Asian nations to increase their mutual international cooperation.

### **Current Moves towards Economic Integration**

As a first effort towards seeking economic cooperation, some of the Central Asian nations have signed preferential trade arrangements with other

nations. In particular, four of the five Central Asian nations – Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan – have banded together as the Central Asian Cooperation (CAC) in 1998.<sup>3</sup> A further step on the path of regional international cooperation was made in 2004, when the leaders of the four nations agreed to the future formation of a common market.

A second major move towards economic collaboration in the region was made when the same four nations signed on to the Shanghai Cooperation Organization (ShCO), which also includes China and Russia. Together, the ShCO occupies 65% of the Eurasian continent, and consists of one-fourth of the world's population. While the main reason for establishing the ShCO was to protect member nations against terrorism, the organization also provides an avenue for economic cooperation among member nations. For example, China has offered low-interest loans to foster trade between member nations, and Russia has invested \$2.5 billion in the gas industry of Uzbekistan. Also, ShCO member countries are involved in more than 100 international projects, such as rebuilding the Great Silk Road from Beijing to St. Petersburg, and constructing pipelines from Central Asia to China. In September 2004, member nations signed an agreement on the free movement of capital, goods, services and technology among ShCO member nations.

Further moves towards increased economic integration are expected to take time. The formation of a free trade area – which means member countries agree to decrease, and eventually eliminate, all mutual trade barriers – may take decades to develop and implement. Additional steps towards economic integration by way of a customs union (the same trade barriers towards nations that are not members of the trade bloc) or a common market (allowing the free

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<sup>3</sup> In 1994, Kazakhstan, Kyrgyzstan and Uzbekistan established the Central Asian Economic Union in 1994, and were joined by Tajikistan in 1998 to form the Central Asian Economic Cooperation. On February 28, 2002, this organization changed its name to the Central Asian Cooperation Organization, and was joined by Russia on May 28, 2004.

movement of labor and capital among bloc members) will take additional time.

### **Implications of Economic Integration for other Nations**

While their benefits may not be measurable in direct economic terms, strengthened economic ties within Central Asia will benefit other nations, including the United States. Improved cooperation among the five nations and resulting economic stability may help contain narcotics trafficking and the development of terrorism. Further, improved stability and economic cooperation may contribute to the development of a reliable supply of natural resources such as oil and gas by making use of existing pipeline infrastructures. Third, enhanced economic growth in the region may enable making investments in infrastructure for developing the production, storage, and transport of foods such as fruits and vegetables. Fourth, a reduction in U.S. cotton subsidies may facilitate an increase in cotton production in the region, thus enabling low cost cotton imports by other nations.

### **Concluding Remarks**

The five nations of Central Asia have a wealth of natural resources, but their people remain poor.

The nations continue to face a number of very costly difficulties in the process of moving to market-based economies. Clearly, some of these difficulties may be overcome more easily by increased economic integration among the Central Asian nations.

### **For Further Reading**

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