



Issues Paper

Soft Infrastructure Development in Central Asia 2020

*Effective Infrastructure Development Through Legislation, Regulation, Policies,
Governance, and Public-Private Frameworks*

by
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Forward

It is both an honor and a pleasure for me to contribute this forward to *Soft Infrastructure Development in Central Asia 2020*, the successor report to EGS's inaugural report, *Future Calling: Infrastructure Development in Central Asia*, issued in 2018.

While some may find this surprising, I believe that the development of soft infrastructure is even more vital to the long-term health and vitality of a national economy than is hard infrastructure. Unlike hard infrastructure, which can be purchased and installed if sufficient funds are available, soft infrastructure must develop locally. While the study of other nations' legal, regulatory, business, and educational systems can certainly help inform the development of an emerging economy's own soft infrastructure, foreign systems cannot be imported and installed the way a bridge or even a factory can. This is because soft infrastructure must be internalized to be effective. Having well-written laws against corruption on the books will have little impact unless government officials at all levels truly believe that those rules are in the best interest of the nation and thus not subject to manipulation or abuse. Similarly, even the most enlightened system of business incentives will produce little results if available benefits are unfairly showered on politically-connected companies rather than those that are truly the most innovative.

Despite the fact that soft infrastructure is more fundamental, it is much less frequently studied than hard infrastructure, likely for the simple reason that it is harder to quantify. Miles of roadway, the number of bridges or airports, and even the density and speed of Internet connections can be tallied and tracked over time with high accuracy. It is much harder, however, to quantify how effective institutions or laws are in creating a level playing field and an environment conducive to constant growth and innovation. As readers will discover in *Soft Infrastructure Development in Central Asia 2020*, the effectiveness of soft infrastructure development often must be measured indirectly through statistics such as the perception of corruption rather than directly. Ultimately, the best measure of how well soft infrastructure has developed is the relative success of nations' economies, since those with weak soft infrastructure will inevitably lag behind similarly endowed nations with stronger commitment to rule of law and a healthy, open business environment.

One reason internalizing soft infrastructure is difficult is that it inevitably means recognizing that some of the old systems of favors and networks of interconnected families must be de-emphasized in favor of transparent, efficient, and universally applied standards. Ultimately, building strong soft infrastructure means building the type of strong respect for the rule of law that leads all national stakeholders to accept that the playing field should be leveled for all and that all will benefit by making it so.

Building effective soft infrastructure is not just about internalizing laws and regulations to reduce corruption and streamline the regulatory process. It is also about creating the type of environment that fosters and rewards innovation and risk-taking.

In resource-intensive economies such as those of Central Asia, there is an added hurdle to developing soft infrastructure. Just as ITIC's 2018 report on hard infrastructure report documented that many nations place more emphasis on the development of hard infrastructure related to extractive industries than to other fields, the same occurs with the development of soft infrastructure. To reach the goal of economic diversification and the long-term resilience it brings, every sector of the economy needs to become a

priority sector. While no “mom and pop” store or tiny workshop will match the economic impact of a huge mine or oil field, the existence of hundreds of thousands of such small enterprises around the country contribute more to growth and stability than highly centralized industries subject to the vulgarities of fluctuating world commodity prices.

While serving as the U.S. Ambassador to Kazakhstan, I had the honor of working directly with then-Prime Minister Maxim Mamedov to convene a group of foreign Ambassadors, investors, and Kazakhstani Cabinet officials who met monthly to examine ways in which the nation’s soft infrastructure could be improved. In many cases, the laws on the books were already good but the implementation was uneven or non-transparent. In other cases, the discussions led directly to concrete changes in regulations or even laws. While those discussions were often quite difficult, they were perhaps the most hopeful development I had seen in nearly three decades of working in nations in transition because the very existence of the group reflected the strength of the government’s commitment to building the type of stronger, more resilient and more equitable system of soft infrastructure that could propel Kazakhstan forward.

It is my hope that this report on *Soft Infrastructure Development in Central Asia 2020* will serve as a catalyst for informed discussion and a renewed commitment to building the basis for long term growth and stability across Central Asia.

Ambassador Kenneth J. Fairfax

U.S. Ambassador to Kazakhstan, 2011-2013

Deputy Executive Director of the International Energy Agency, 2013-2014

I. Introduction

The political economy of the resource-rich and geographically strategic region of Central Asia is continuing to evolve. Once isolated and impoverished, the Republics of Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan, and Turkmenistan have broken free from their Soviet legacies of central planning to pursue economic development strategies, which increase connectivity with the global marketplace.

The opening up of the Central Asian Republics (CARs) since gaining independence in 1991 has led to massive progress in the quality of life and standard of living for the region's citizens. Proximity to huge markets, rich resource endowments, educated populations, and economic liberalization has fueled this progress. Indeed, the region has averaged GDP expansion of over 5% since 2013, but in many cases, this is slowing.¹ A weakening global economy, depressed commodity prices – the backbone of Central Asian countries – and the lack of diversification within these markets are taking their toll. The region is still far from its full economic potential. To realize this potential, the CARs must embrace reform strategies to develop their “hard” and “soft” infrastructure systems.

Figure 1.

	Population (m)	Nominal GDP (USD billion)	GDP growth (%; 2013-2017, average)	GDP per capita (current prices, USD)	Trade intensity (total trade, % of GDP)
Azerbaijan	9.8	40.8	1.3	4,151	38.4
Kazakhstan	18.2	159.4	3.3	8,762	45.1
Kyrgyz Republic	6.3	7.6	5.5	1,208	78
Mongolia	3.1	11.5	5.7	3,755	73.5
Tajikistan	8.8	7.3	6.8	828	54.6
Turkmenistan	5.7	41.7	7.9	7,298	33.1
Uzbekistan	32.1	73	7.4	2,272	26.5
CAREC-7	84	341.3	4.6	4,063	41

Source: The EIU calculations using data from “Asian Economic Integration Report 2018,” ADB. CAREC-7 excludes some economies which are part of the broader Central Asia Regional Economic Cooperation blog.

Among the most significant challenges to continued growth in Central Asia is the so-called “infrastructure gap.” The Asian Development Bank (ADB) predicts that Central Asia will require upwards of \$33 billion in annual infrastructure spending through 2030 to meet development needs.² Growing populations,

¹ “Enhancing Competitiveness in Central Asia, Competitiveness and Private Sector Development.” *OECD*, 2018. Accessed July 20, 2019. <https://doi.org/10.1787/9789264288133-en>.

² “Meeting Asia’s Infrastructure Needs.” *Asian Development Bank*, 2017. <https://www.adb.org/publications/asia-infrastructure-needs>

rising energy demand, rapid urbanization, and increasing productivity necessitate the build-out of “hard infrastructure” -- those transportation, telecommunications, and energy networks that form the foundation of a developing economy.

Policymakers in Central Asia are therefore prioritizing the construction of these critical projects, but budgetary, technical, and bureaucratic constraints across the region indicate that states are struggling to meet swelling demand.

For hard infrastructure development to be successful, however, “soft” infrastructure regimes must also be in place. Whereas hard infrastructure includes the physical: bridges, airports, highways, and power plants, soft infrastructure entails the institutional: policies, governance, taxes, laws and regulations. Soft infrastructure can be thought of as the software, on which the hard infrastructure is developing and running. It includes a modern policy and financial environment, which enables hard infrastructure projects to develop and function. For the positive effects of expensive hard infrastructure to be felt – economic and social innovation, knowledge sharing, trade facilitation, productivity increases, higher standard of living – an infrastructure investment-friendly climate must first exist. Herein lies the importance of soft infrastructure.

II. The Key Pillars of Soft Infrastructure

A. Private Sector Competition

The Central Asian Republics have long understood the need to update legal and regulatory frameworks to facilitate the development of their economies in the post-Soviet era. These legislative and regulatory policies include the encouragement of private sector competition, a feature that is critical to sustained economic growth and competitiveness in the global marketplace.

Such region-wide trends as CAR cultivation of private-public partnership agreements with large western financial organizations, the breakup of state-owned enterprises, and removal of bureaucratic red tape are beginning to take shape, but often not quickly enough – especially when high volumes of capital expenditure infrastructure investment are required, and fast.³

Current CAR economic growth models are based on the extraction and production of natural resources and yield mixed results. The rate of demographic growth outpaces the GDP increase, causing economic migration.

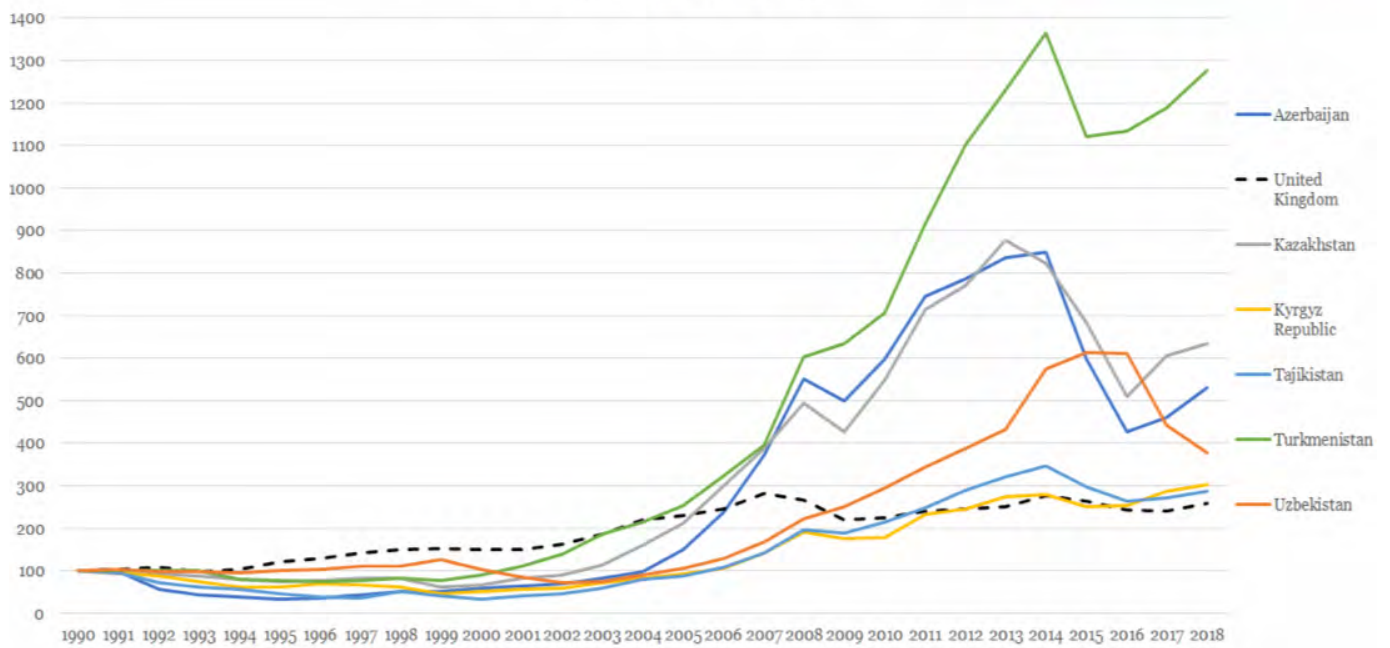
Since the turn of the millennium, the CARs have shown rather impressive growth, but it has come at the expense of economic diversification and institutional development. The Soviet legacy and an over-reliance on natural resources have led to the proliferation of state-controlled enterprises to the detriment of the private sector. The heavy involvement of an oftentimes corrupt and inefficient public sector in infrastructure development brings high project and management costs, frequently leading to projects not reaching completion or the government bearing the burden of significant over-run costs.

³ “Central Asia: Governance, geopolitics and development challenges” *Overseas Development Institute*. May 2007. Accessed July 20, 2019. <https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/138.pdf>

Figure 2

Central Asian Republics' GDP since 1990
(1990=100, Current USD)

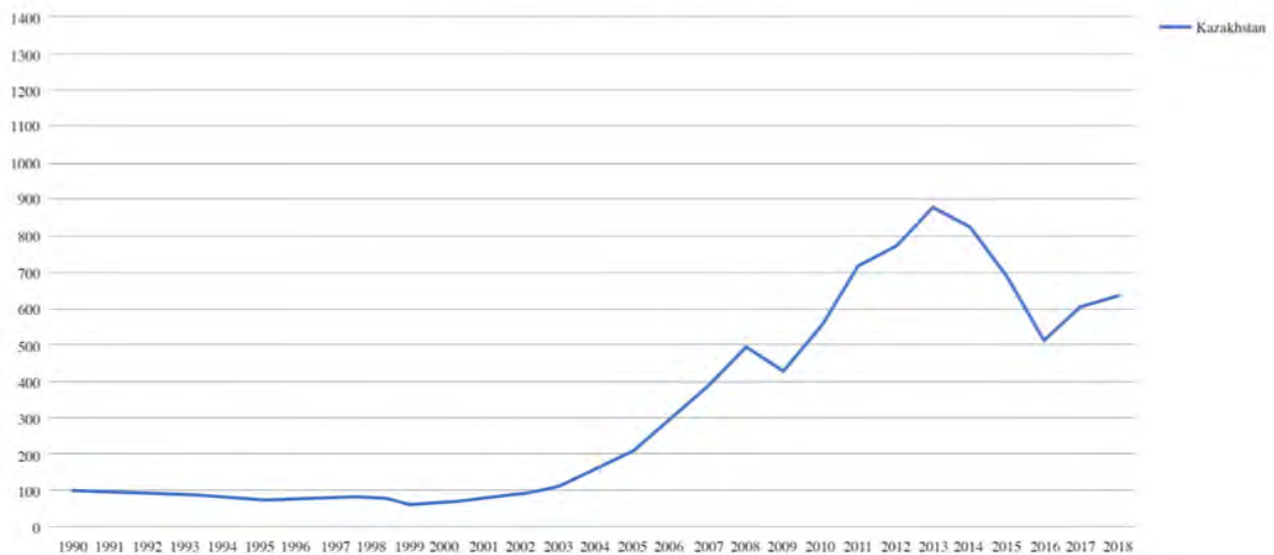
ERC ECONOMIC RESEARCH COUNCIL



Source: ERC analysis of World Bank data

Figure 3

Kazakhstan's GDP since 1990
(1990 =100, Current USD)



Source: ERC analysis of World Bank data

(Source: "Central Asian Republic's GDP since 1990," Economic Research Council, 2019.)

While the public sector has a pivotal role to play in initiating infrastructure development, large-scale projects cannot be adequately funded or maintained in an environment where the private sector is restricted. Increasing the share of the private sector within the CARs, including in building the infrastructure, should yield higher wages and, more importantly, a stable rate of economic growth that isn't reliant on commodity prices.

According to the Organization for Economic Co-operation and Development (OECD), “the aggregate gross domestic product (GDP) of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan grew at an average annual rate of 7% during 2000-16” – despite the oil and gas price decline that occurred from 2014-2015.⁴ Yet, conversely, the CARs have begun – most notably Kazakhstan – to recognize the need for a more diverse economic model.

Even within the most competitive economy in Central Asia – Kazakhstan – the need for promoting private sector competition is apparent. Kazakhstan underwent exponential economic growth throughout the 2000s associated with the simultaneous increase in oil and gas prices. These hydrocarbon revenues allowed the state to largely postpone dealing with long-term challenges that stem from a lack of market liberalization and economic diversification. Indeed, following the 2008 financial crisis, the country has yet to re-test those record levels of economic growth. In fact, the opposite has occurred, and Kazakhstan's pace of development has declined. This year, the European Bank for Reconstruction and Development (EBRD) predicts annual GDP growth will be 3.5%, down from 7.4% in 2011 and 4% in 2018.^{5,6}

By strengthening the private sector and diversifying their productive industries, Central Asian countries can transition their national economies to more sustainable, modern economic practices. The World Bank projects that “without higher productivity, Kazakhstan will face continuously declining rates of income per capita.”⁷ This advice does and should apply to all of the CARs if they are serious about reforming their long-term economic development strategies for the 21st century global economy.

By implementing reforms that promote private sector growth, the Central Asian countries can improve market competitiveness and diversify their economies with more opportunities in a broader array of sectors. New sectoral growth and higher productivity will bring new infrastructure needs in a virtuous cycle, from power generation to telecommunications networks. However, as we learned from the reforms in the Asian Tiger countries, it is the changes in laws, regulations, and policies, that will ensure such transition.

B. Fair and Effective Tax Regimes

Taxation is an integral part of a country's development policy that provides government with the funding required to build and operate infrastructure, on which economic development and growth are based. Transparent and consistent tax laws are also critical for investors who value predictability. Fair legal and

⁴ “Enhancing Competitiveness in Central Asia, Competitiveness and Private Sector Development.” *OECD*. 2018. Accessed July 20, 2019. <https://doi.org/10.1787/9789264288133-en>

⁵ “IMF DataMapper.” *International Monetary Fund*. https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/KAZ

⁶ “Kazakhstan Overview”. *European Bank for Reconstruction and Development*. <https://www.ebrd.com/where-we-are/kazakhstan/overview.html>

⁷ “The Challenge of Economic Diversification Amidst Productivity Stagnation.” *World Bank in Kazakhstan*. Fall 2018. <http://pubdocs.worldbank.org/en/265701543402099127/Kazakhstan-Economic-Update-Fall-2018-en.pdf>, pp. 15.

regulatory frameworks are therefore the foundation of a functioning and effective tax system. They provide a sustainable business environment, shape the way government activities are undertaken, and play a central role in domestic resource mobilization. Ultimately, when interwoven with good governance, taxation sets a foundation for growth, upon which to promote export activities, private sector growth, and complex international economic relations.

Successful tax regimes require constant reform to balance growth, tax revenue, and government equity.⁸ The Central Asian nations have, in recent years, dedicated themselves to testing reform policies to establish a balance of tax and non-tax revenues that allow for more comprehensive social programming and the amelioration of the business climate to attract foreign investment.

Tajikistan, for instance, has capitalized upon its mineral resources with vast tax exemptions for mining and mining-related industries. Consequently, approximately 60% of FDI inflows were dedicated to the expansion of the mining business in 2018.⁹ While tax leniency has spurred development, Tajikistan's economic resilience and stability will depend, in part, upon the acceleration of policy reforms improving the quality of tax collections from previously exempt and lucrative industries.¹⁰

Widening the tax base is necessary for the government to reform otherwise financially constrained programs. In Kyrgyzstan, 2017 tax revenue performance achieved "a strong 24.8% of GDP (up from 22.3% a year earlier)."¹¹ Tax revenue is expected to rise as a percentage of GDP through 2019 and 2020 following policies that will further widen the tax base.¹² For Uzbekistan, a widened tax base caused a surge in value-added tax and mining tax revenues in 2018. The gain in fiscal space was offset by increased expenditure, but these allocations went towards critical government social spending projects – including hard infrastructure. At this time the overall fiscal deficit remained around the moderate 2% of GDP.

In 2019, Uzbek authorities began to implement "major tax reform designed to simplify taxes, expand the standard corporate tax regime and value-added tax, while reducing the tax burden on private firms and workers."¹³ On January 1, 2018, Kazakhstan implemented a new tax code, introducing 'Principle of Good Faith' that provides taxpayers with generous rights – including the burden of proof for tax violations falling on tax authorities rather than the taxpayer.¹⁴ Such measures are important examples of how Central Asian governments should aim to sustain infrastructure development – via tax reform.

⁸ "World Economic and Financial Surveys: Regional Economic Outlook - Middle East and Central Asia." *International Monetary Fund*. November, 2018. <https://www.imf.org/en/Publications/REO/MECA/Issues/2018/10/02/mreo1018>, pp. 44.

⁹ "Tajikistan, Country Economic Update: Rogun HPP – Potential Resource for Building Human Capital." *World Bank Group*. Fall 2018. Accessed July 20, 2019: <http://pubdocs.worldbank.org/en/624741547182513272/Tajikistan-CEU-Fall-2018-FINAL.pdf>, pp. 5.

¹⁰ *Ibid.*, pp. 2.

¹¹ "The World Bank in the Kyrgyz Republic – Country Snapshot." *The World Bank*. October 2018. Accessed July 20, 2019: <http://pubdocs.worldbank.org/en/780791539098338081/Kyrgyz-Republic-Snapshot-Fall2018.pdf>, pp. 3.

¹² "The World Bank in the Kyrgyz Republic – Country Snapshot." *The World Bank*. October 2018, pp. 3.

¹³ "IMF Executive Board Concludes 2019 Article IV Consultation with the Republic of Uzbekistan." *International Monetary Fund*. May 9, 2019. Accessed July 20, 2019. <https://www.imf.org/en/News/Articles/2019/05/09/pr19155-republic-of-uzbekistan-imf-executive-board-concludes-2019-article-iv-consultation>.

¹⁴ "Kazakhstan Enacts New Tax Code." *Baker McKenzie*. January 10, 2018. <https://www.bakermckenzie.com/en/insight/publications/2018/01/kazakhstan-new-tax-code>

C. Good Governance

Good governance describes the decision process of how public institutions conduct public affairs and manage public resources in the best interest of the country. Equality and prosperity are impossible to achieve without good governance as well as strong social and economic mechanisms to support growth. Since gaining independence from the Soviet Union, the Central Asian Republics have attempted to find sustainable governance models and to place their economies, long-tied to Moscow, on a stable footing.

The degrees of their success differ. The region's governments – with some notable exceptions – are still struggling to address political and social issues that hinder economic growth and investment. Systemic corruption, lack of transparency, human rights violations, Soviet-style censorship across the media landscape, and high protectionist walls that encumber trade have made it difficult to foster growth and provide the region with necessary infrastructure development.

Each year, The World Bank issues rankings that examine the quality of governance in countries around the globe, looking at six indicators – voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption.¹⁵ All five Central Asian countries fall in the bottom 35% of the World Bank's Governance Indicators, pointing at a strong need for governance reform in the region.¹⁶

Figure 4. Corruptions Perception Index 2018		
Country	Rank*	Score*
Kazakhstan	124	31
Kyrgyz Republic	132	29
Uzbekistan	158	23
Tajikistan	152	25
Turkmenistan	161	20
<i>*rank is position relative to other countries (out of 180).</i>		
<i>*score is perceived level of public sector corruption (0 – highly corrupt, 100 – very clean).</i>		
<i>Based on data from the Corruption Perceptions Index by Transparency International.¹⁷</i>		

Corruption remains a significant issue throughout the region. Systemic and endemic in nature, it delegitimizes and weakens government institutions (see Figure 4: *Corruptions Perception Index 2018*). The OECD, after extensive reform-monitoring work in the region, concluded in its latest review from

¹⁵ "Worldwide Governance Indicators". *The World Bank Group*. 2019. Accessed July 17, 2019. <https://info.worldbank.org/governance/wgi/#home>

¹⁶ "A regional agenda for economic diversification in Central Asia," in *Enhancing Competitiveness in Central Asia*. OECD. 2018. Accessed July 17, 2019. <https://doi.org/10.1787/9789264288133-4-en>, pp. 26.

¹⁷ "Corruptions Perception Index 2018". *Transparency International*. 2018. Accessed July 17, 2019. <https://www.transparency.org/cpi2018>

2013-2015 that, even though progress has been made in various areas, issues pertaining to corruption prevention and punishment remain firmly present.¹⁸ Additionally, the OECD found in its Foreign Bribery Report that two-thirds of foreign bribery cases occur in the extractive, construction, transport and storage, and communication sectors – all of which play huge roles in infrastructure development.¹⁹ Such properties of good governance as proper regulation and legal frameworks, coupled with a prolonged public education campaign, are essential in combating corruption and distrust within institutions and business environments.

In order for Central Asian nations to foster an environment conducive to economic growth, they must advance comprehensive, long-term development initiatives that seek to modernize regulatory frameworks by eliminating over-regulation, enhancing transparency, facilitating policy discourse and tamping down on corruption.

D. Foreign Direct Investment (FDI)

The world's comparative economic performance demonstrates that good governance, private sector competition, and pragmatic tax structures create better investment conditions. Central Asian countries suffer from insufficient capital resources of their own and are in need of foreign investment, management expertise, and technical assistance in legislative and regulatory areas.

FDI is a critical component in providing economic development, income growth and employment in developing countries and emerging economies. The Central Asian Republics have introduced domestic policies to reform, facilitate and attract much-needed outside investment in various sectors with varying degrees of success. The economic and social benefits of FDI are immense and often lead to technological advancement, human capital formation and growth in international trade. FDI also drives improvements in environmental and social conditions through responsible corporate policies.

FDI will be critical for Central Asia to sustain future economic growth. In the next ten years, potential greenfield FDI in Central Asia is estimated to be \$170 billion, which is still lower than the World Bank projection of the region's needs.²⁰ Extractive industries related to oil, gas and metals have attracted the majority of investment in the region. In the last decade, 54% of FDI in Kazakhstan and 40% of FDI in Uzbekistan was invested in the oil and gas industries.²¹ Though other industry sectors, such as tourism, agriculture, and financial services, have yet to become fully attractive in most countries, they are already developing opportunities for investment.²² The region's main source of investment comes from neighboring Russia and China, as well as the EU. China's investment and presence in the region, most significantly in Kazakhstan and Turkmenistan, has gradually increased due the emerging superpower's thirst for energy and its Belt and Road Initiative (BRI).

¹⁸ "A regional agenda for economic diversification in Central Asia," in *Enhancing Competitiveness in Central Asia*, pp. 14.

¹⁹ "Getting Infrastructure Right: A framework for better governance." *OECD*. 2017. Accessed July 17, 2019. <https://doi.org/10.1787/9789264272453-en>, pp. 14. "OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials." *OECD* 2014. https://www.oecd-ilibrary.org/governance/oecd-foreign-bribery-report_9789264226616-en, pp. 22.

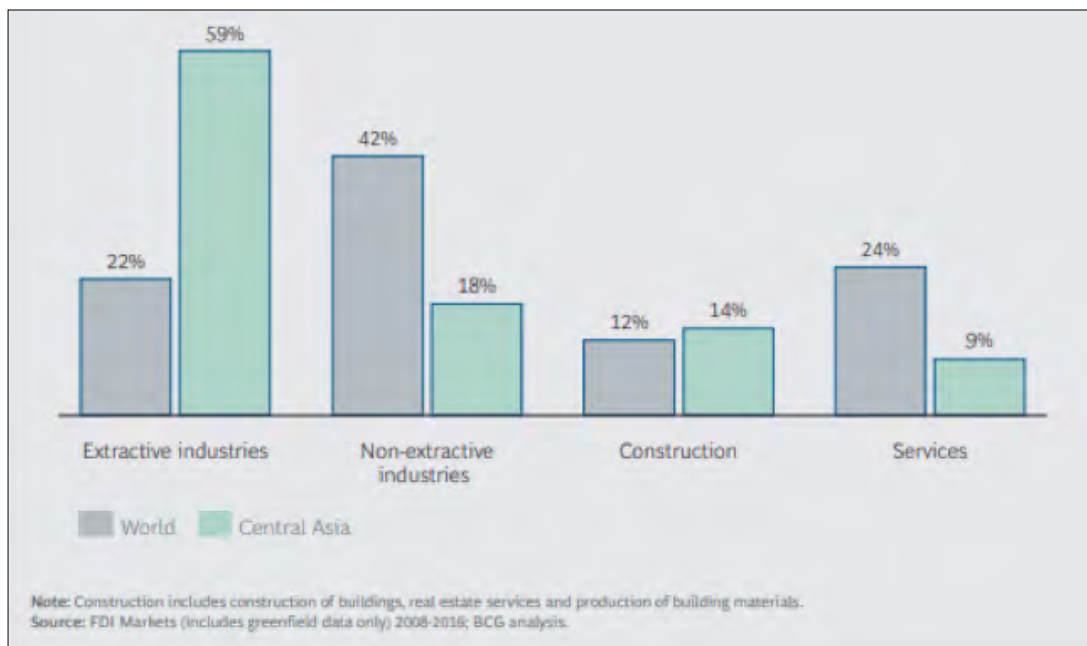
²⁰ "Investing in Central Asia: One Region, Many Opportunities." *Boston Consulting Group*. December 2018. https://www.bcg.com/Images/BCG-Investing-In-Central-Asia-report-ENG_tcm26-212857.pdf, pp. 5.

²¹ *Ibid.*, pp. 20, 25.

²² *Ibid.*, pp. 5.

Despite a growing population and abundant natural resources, which attract investment to the region, there are several barriers that hinder further investment. Telecommunication, financial services and trade sectors only make up 9% of greenfield FDI in Central Asia in comparison to 24% worldwide.²³ Albeit improving since Uzbek President Shavkat Mirziyoyev's election in 2016, poor regional cooperation to facilitate trade leaves Central Asian countries isolated from each other and from the global market. Trade in the region relies on only a few specialized sectors that reach a small number of customers. Intraregional exports account for less than 6% of total exports in the region.²⁴ Central Asian countries are critically linked to neighboring economies, and an over-reliance on natural resources leaves the region vulnerable to economic downturns and unpredictable commodity prices.

Figure 5. Greenfield FDI in Central Asia and the World



Source: FDI Markets (including greenfield data only). 2008-2016; BGC analysis.²⁵

The regional business climate is not overly inviting to investors in view of high transportation costs due to long distances, extended delays at border crossings, corruption, flawed legal framework and limited access to the global market. Gradually, reforms have been introduced to create a favorable climate for investors. In 2010, a customs union was created between Kazakhstan, Russia and Belarus to reduce barriers and improve efficiency in cross-border trade.²⁶ In January 2015, Russia, Armenia, Belarus, and Kazakhstan launched the Eurasian Economic Union. Kyrgyzstan joined eight months later. The proclaimed purpose of the union is to reduce barriers to trade between members while erecting external tariff walls. More recently, this economic partnership linking roughly 183 million people signed an agreement with China – further connecting the region economically to China's Belt and Road Initiative and to larger trade

²³ "Investing in Central Asia: One Region, Many Opportunities." Boston Consulting Group. December 2018, pp. 35.

²⁴ Ibid., pp. 15.

²⁵ Ibid., pp. 34.

²⁶ "Connecting Central Asia with Economic Centers". Asian Development Bank Institute. 2014. <https://www.adb.org/sites/default/files/publication/159307/adb-connecting-central-asia-economic-centers-final-report.pdf>, pp, 54.

markets.^{27, 28}

In an effort to attract investors, the Government of Kazakhstan attempted to address corruption concerns through the 100 Precise Steps National Plan introduced by President Nursultan Nazarbayev in 2015, proposing laws against corruption and institutional reforms.²⁹ Since independence, Kazakhstan attracted more than \$320 billion in foreign direct investment, which makes it the region's leading investment hub.³⁰ In recent years, Uzbekistan has also taken measures to attract foreign investors by reforming currency export restrictions and visa requirements.

Figure 6. Ease of Doing Business			
Country	Rank	EODB score	EODB change
Kazakhstan	28	77.89	+0.73
Kyrgyz Republic	70	68.33	+2.57
Uzbekistan	76	67.40	+1.08
Tajikistan	126	57.11	+0.08
Turkmenistan	--	--	--
<i>*rank is position relative to other countries (out of 180).</i>			
<i>*score is perceived level of public sector corruption (0 – highly corrupt, 100 – very clean).</i>			
<i>Source: World Bank Doing Business Report 2019³¹</i>			

However, there are further steps governments should implement to foster economic growth through FDI. Regulatory reforms and a legal framework that promote a market-based economy are essential in bringing further investment to the region. A shift towards value-added manufacturing and services can provide a more balanced revenue base and alleviate the reliance on a small number of industries for investment and growth.

Significant investment in agricultural processing and food manufacturing will be needed, as Central Asian countries currently produce and export mainly raw goods and materials. Regional cooperation among Central Asian countries with cohesive economic and regulatory policies will help further facilitate

²⁷ Oleg Remyga "Linking the Eurasian Economic Union and China's Belt and Road." *Center for Strategic and International Studies*. November 9, 2018. <https://reconnectingasia.csis.org/analysis/entries/linking-eurasian-economic-union-and-chinas-belt-and-road/>

²⁸ "The Eurasian Economic Union: Putin's Geopolitical Project." *Foreign Policy Research Institute*. October 2018. <https://www.fpri.org/wp-content/uploads/2018/10/rpe-6-dragneva-final.pdf>, pp. 5.

²⁹ "Investing in Central Asia: One Region, Many Opportunities." *Boston Consulting Group*. December 2018, pp. 22.

³⁰ Saltanat Boteu. "AEF Participants Call for Central Asian Integration through Connectivity, Developing Human Capital." *The Astana Times*. May 20, 2019. Accessed July 20, 2019. <https://astanatimes.com/2019/05/aef-participants-call-for-central-asian-integration-through-connectivity-developing-human-capital/>.

³¹ "Doing Business 2019". *The World Bank*. 2019. https://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf

investment.³² The Central Asia Regional Economic Cooperation (CAREC) has been instrumental in opening up cross-border relations to improve trade and infrastructure projects.³³

Central Asia has a large amount of land, 75% of which can be utilized for agriculture.³⁴ The region could greatly benefit from investment as issues with poor irrigation technology have hindered growth in the sector. Kazakhstan has attracted a \$180-million investment from the European Bank for Reconstruction and Development (EBRD) to build new and renovate existing irrigation systems.³⁵ Meanwhile, local anti-Chinese moods stand in the way of further agricultural development with Kazakhstan's big neighbor's assistance. In 2016, Kazakhstan experienced protests over worries that a new leasing law could potentially allow foreigners, and the Chinese in particular, to purchase Kazakhstani land, leading to then-President Nazarbayev to postpone the law.³⁶ If such a law is revived, a consistent and thorough public information campaign will be necessary to change public attitudes towards foreign ownership of land.

Tourism is another industry that has been underdeveloped by governments but has the potential to attract FDI to the region. Currently, greenfield FDI for tourism in the region is at 0.8% compared to 4% worldwide.³⁷ The industry as a whole is plagued by poor customer service and insufficient accessibility to the region due to aging infrastructure and limited airport and commercial flight availability. A single-visa program has been undertaken by Kazakhstan's Ministry of Culture and Sport in partnership with the "Kazakh Tourism" company to address cross-border mobility issues with adjacent countries.³⁸ Work visas for hotel and resort management from abroad would be a strong addition to measures for the tourism sector improvement.

If Central Asian governments address the aforementioned issues, the region is well-positioned for further FDI and growth, sitting between prominent economies such as China and India while also being a critical component of the BRI. Greenfield FDI to Central Asia has accumulated to \$113 billion since 2008 (Kazakhstan 70%, Uzbekistan 16%, Turkmenistan 8%, Kyrgyz Republic and Tajikistan combined less than 6%).³⁹ With the proper implementation of policies and a legal and regulatory framework that facilitates investment, the region will benefit greatly from increased investment in much needed projects that will bring technology, infrastructure and growth.

E. Fostering Effective Public-Private Partnerships

In addition to FDI, public-private partnerships (PPPs) are an important tool that investors and governments can use to facilitate large-scale infrastructure projects in emerging economies. Using PPPs as a project finance model allows emerging countries to utilize the technology, innovation and expertise the private sector has to offer while using the government to 'de-risk' projects through guarantees and access

³² "Investing in Central Asia: One Region, Many Opportunities." Boston Consulting Group. December 2018, pp. 6

³³ *Ibid.*, pp. 12.

³⁴ *Ibid.*, pp. 38.

³⁵ *Ibid.*, pp. 40

³⁶ Jack Farchy. "China Plans to Invest \$1.9bn in Kazakh agriculture." *Financial Times*. May 9, 2016. <https://www.ft.com/content/9c84a0f4-15d3-11e6-9d98-00386a18e39d>

³⁷ "Investing in Central Asia: One Region, Many Opportunities." *Boston Consulting Group*. December 2018, pp. 35.

³⁸ *Ibid.*, pp. 50.

³⁹ *Ibid.*, pp. 34.

to capital.⁴⁰ Appropriate financial structures, regulatory policies and incentives can mitigate the risks associated with public-private initiatives. PPP frameworks often provide incentives to the stakeholders financing and managing the project, ensuring a higher-quality project that government agencies may have a hard time achieving. Large-scale projects often suffer from set-backs and delays, leading to wasted resources and funding. Private sector participation in projects can alleviate these burdens away from Central Asian governments.

The Central Asian Republics could greatly benefit from PPPs if legal and regulatory barriers can be addressed. Inadequate protection of property rights, heavy state involvement, corruption, and inconsistent statistical data has deterred competition and PPPs from being implemented more broadly in the region. There is a growing need for infrastructure and investment in the region – with 60% of the investment deficit expected to be met by the private sector and other non-public financial resources.⁴¹

Several countries in the region have introduced reforms and institutions to foster PPP in infrastructure projects. Kazakhstan is a leader in PPP development, adopting a new law in 2015 which created a common legal framework to regulate public-private partnership projects. Moreover, the country's PPP Center is the only official body in the region that promotes and oversees PPP projects. Since Kazakhstan introduced its Law on Concessions in 2006, 140 projects have been approved and has alleviated pressure on the national budget by about 90.6 billion tenge (US\$281.7 million).⁴² The government has continued to attract PPP mechanisms by introducing regulations to limit burdensome procedures and reduce the approval period for projects with the intention these improvements will increase project completion rates.⁴³

The Uzbek government has signed PPP deals to update the Tashkent airport and build a thermal power station, part of a larger decree totaling 15 PPP projects signed by President Shavkat Mirziyoyev.⁴⁴ In May of 2019 Tashkent passed a law "on Public Private Partnerships" which officially permits and regulates their use.⁴⁵ Tajikistan established a PPP Unit in 2013, with \$956 million invested in PPP projects since 1990, the majority of which have been hydro-electric energy projects.⁴⁶

The governments in Central Asia have begun to reform regulatory and legal frameworks to attract and facilitate private sector participation in infrastructure projects. In 2017, Uzbekistan introduced reforms that liberalized the foreign exchange currency, removing barriers that previously made it difficult for the

⁴⁰ "Realizing The Potential of Public-Private Partnerships to Advance Asia's Infrastructure Development". *Asia Development Bank*. January 2019. <https://www.adb.org/sites/default/files/publication/479396/potential-ppp-asia-infrastructure.pdf>, pp. 18.

⁴¹ "Call for Papers: Measuring Impacts and Financing Infrastructure in Central Asia Regional Economic Cooperation Countries." *Asian Development Bank Institute*. June 22, 2018. <https://www.adb.org/adbi/research/call-for-papers/measuring-impacts-financing-infrastructure-carec>

⁴² Assel Satubaldina. "PPPs have reduced burden on Kazakh budget by \$282 million." *The Astana Times*. April 11, 2018. <https://astanatimes.com/2018/04/ppps-have-reduced-burden-on-kazakh-budget-by-282-million/>

⁴³ Ibid.

⁴⁴ "Uzbekistan Offers PPP Deals to Foreign Investors in Banking and Infrastructure". *Silk Road Briefing*. May 8, 2019. <https://www.silkroadbriefing.com/news/2019/05/08/uzbekistan-offers-ppp-deals-foreign-investors-banking-infrastructure/>

⁴⁵ "New Opportunities for Public-Private Partnership." *United Nations Development Programme*. May 23, 2019. <http://www.undp.org/content/uzbekistan/en/home/presscenter/articles/2019/05/23/new-opportunities-for-public-private-partnership.html>

⁴⁶ "Tajikistan". *PPP Knowledge Lab*. <https://pppknowledgelab.org/countries/tajikistan>

private sector to access the foreign exchange market.⁴⁷ Foreign exchange convertibility reforms have greatly increased private sector participation according to the World Bank and IFC.⁴⁸

Stronger institutions and legal frameworks serve to alleviate investors' fear of corruption and lack of transparency. Availability of reliable and accurate data for stakeholders will result in smarter business decisions and promote investor confidence. Project finance structures that allocate risks appropriately allow for better management and success of high CapEx projects. In this vein, development banks must be involved in large-scale infrastructure projects to help mediate any issues between public and private partners and monitor project implementation thus reducing the risk of delays in the project.⁴⁹ Governments can also provide subsidies to make infrastructure projects more economically viable and reduce risk and capital requirements for private investors.⁵⁰

Plagued by aging infrastructure, Central Asian governments need assistance from the indigenous private sector, international development institutions and multinational companies to secure financing for the large-scale infrastructure investments required to bolster their economic growth. Public sector and development institutions are not sufficient and Central Asian governments must begin to reform burdensome regulations that deter private sector investment. The next section reviews these issues by country.

III. Regional Overview: Applying Best Practices

A. Kazakhstan

The Republic of Kazakhstan accounts for approximately 50% of Central Asia's GDP largely due to consistent market reforms and general political stability.⁵¹ 30 years of President Nazarbayev's leadership provided both an ambitious vision of state-building and economic development -- and the appropriate implementation of forward-looking public policies.

Kazakhstan's substantial oil reserves and other natural resources coupled with its immense geographic area form significant competitive advantages for the country's economic growth. Development strategies focused on massive infrastructure projects to exploit these resources and connect the vast country through highways, trains, airports, and telecommunications have transformed Kazakhstan into a model of advancement from a lower-middle income to an upper-middle income state.

Kazakhstan has effectively used economic reforms to maximize output from its industrial sectors resulting in heavy multinational investment in its oil and gas sector. However, the challenge of escaping the upper middle-income trap will be difficult to overcome as very few countries have been able to accomplish the transition from upper-middle income status to the OECD membership the Kazakhstani government yearns to attain.

⁴⁷ "Uzbekistan Reforms for a Sustainable Transformation Toward a Market Economy Development Policy Operation." *The World Bank*. May 29, 2018. <http://documents.worldbank.org/curated/en/554291530243050278/pdf/Uzbekistan-Reform-PD-06042018.pdf>, pp. 18.

⁴⁸ *Ibid.*, pp. 18.

⁴⁹ "Realizing The Potential of Public-Private Partnerships to Advance Asia's Infrastructure Development". *Asia Development Bank*, pp. 54.

⁵⁰ *Ibid.*, pp. 66.

⁵¹ "GDP per capita (current US\$)." *The World Bank*. 2019. <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?end=2006&locations=TJ-UZ-KG-TM-KZ&start=1987>.

In spite of great challenges, Kazakhstan's 20-year period of substantial economic growth and stability has attracted the attention of various foreign institutions and investors. The EBRD has committed an impressive \$12.3 billion to nearly 750 projects in Kazakhstan and has reiterated its willingness to support transparent, high-quality investments in Central Asia.⁵² Such a pronouncement reflects the comfortable investment environment Kazakhstan has created to entice external capital inflows.

Kazakhstan is a key partner in China's Belt and Road Initiative, receiving hundreds of millions of dollars in investment for infrastructure development.⁵³ President Xi Jinping of China announced the commencement of the now famous BRI expansion strategy in Nur-Sultan (formerly Astana) in 2013 – symbolizing the growing economic relationship between China and the Central Asian powerhouse. However, Russia, the EU and the U.S. remain critical sources of investment and financial partnerships for Kazakhstan.

With its internationally-integrated economy growing, the structural integrity of Kazakhstan's financial sector was and remains the greatest concern facing investors attracted to the country's otherwise warm business climate. However, Kazakhstani authorities have proven themselves adept in dealing with potential economic weakness through adaptive policy reforms.

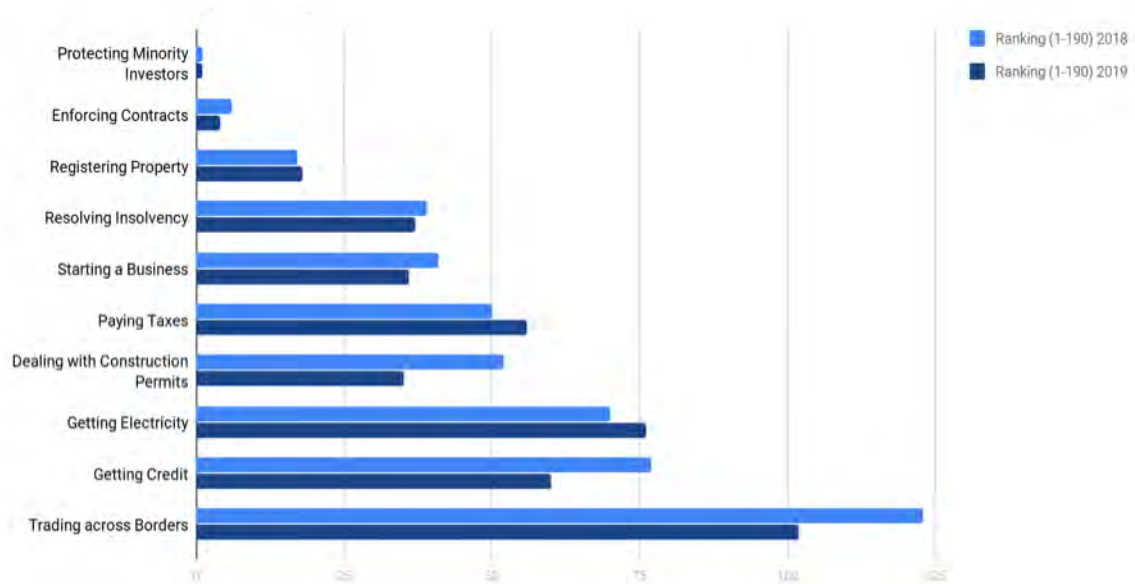
The global financial crisis of the late 2000's weakened Kazakhstani banks, and the 2015-16 drop in commodity prices constrained oil remittances to a point at which the non-oil deficit reached 12.9% of GDP.⁵⁴ Yet, adoption of a difficult fiscal consolidation agenda succeeded in reducing the non-oil deficit to 4.9% and in 2016, measured adjustments to public spending were followed by the addition of a rule for the National Fund of the Republic of Kazakhstan (NFRK) - the fund protecting oil-related revenues against unfavorable external shocks.⁵⁵ The rule outlined the restriction that guaranteed transfers from the NFRK to the federal budget.

⁵² Anthony Williams. "EBRD forum in Beijing to promote investment in Central Asia." *European Bank for Reconstruction and Development*. November 9, 2018. <https://www.ebrd.com/news/2018/ebrd-forum-in-beijing-to-promote-investment-in-central-asia.html>.

⁵³ Kenneth Rapoza. "Goldman Sachs Follows China into Kazakhstan." *Forbes*. November 8, 2018. Accessed July 3, 2019. <https://www.forbes.com/sites/kenrapoza/2018/11/08/goldman-sachs-follows-china-into-kazakhstan/#475958077869>.

⁵⁴ "Reforming Kazakhstan: Progress, Challenges and Opportunities." *OECD Publishing*, 2017. <https://www.oecd.org/eurasia/countries/OECD-Eurasia-Reforming-Kazakhstan-EN.pdf>, pp. 23.

⁵⁵ *Ibid.*, pp. 23.

Figure 7. Kazakhstan: Ranking on Doing Business Areas 2018 & 2019

Source: "Doing Business," The World Bank, 2018 & 2019.

https://www.doingbusiness.org/en/data/exploreeconomies/kazakhstan#DB_pi

These transfers must be in tenge - as opposed to the US dollar - and will be reduced to a maximum of around 2 trillion tenge (around \$6 billion) by 2020. Such consolidatory policies has been a driving force behind the diversification of the Kazakhstani economy.⁵⁶

Relating to diversification efforts, Kazakhstan has significant potential for further foreign investment and has been creative in building its favorable business climate (see Figure 7: *Kazakhstan: Ranking on Doing Business Areas, 2018*). The Government of Kazakhstan established the Astana International Financial Center (AIFC) to reaffirm investor confidence and situate Kazakhstan as a financial hub for the region.⁵⁷ The co-related Astana International Exchange (AIX) has served as a forum by which international financial institutions have pledged their renewed faith in Kazakhstan's economy - banks from Singapore to Shanghai have registered with the exchange.

Despite significant growth, Kazakhstan still faces real challenges to sustained development. A solid legislative base, transparent regulation, a grip on corruption, good governance and economic diversification, are the baseline achievement Kazakhstan will have to demonstrate in coming years to maintain the influx of foreign investment. Kazakhstan now faces the risk of the middle-income trap and will be unable to achieve the next level of economic productivity without the proactive policy agendas that define soft infrastructure development. Judging by the initial statements and actions, the Administration of President Kassym-Zhomart Tokayev is aware of that.⁵⁸

The continued advancement of Kazakhstani infrastructure development now depends upon recently

⁵⁶ Ibid., pp. 25.

⁵⁷ "Investing in Central Asia: One Region, Many Opportunities." *Boston Consulting Group*. December 2018, pp. 13.

⁵⁸ "Reversing Productivity Stagnation." *The World Bank*. October 31, 2018. Accessed June 28, 2019. <http://documents.worldbank.org/curated/en/615051550479498194/pdf/Kazakhstan-Country-Economic-Memorandum-fina.pdf>, pp. ii.

elected President Tokayev's and his Cabinet and staff's ability to implement continuity and innovation in the realm of policy reform. Before his departure from the presidency, Nursultan Nazarbayev outlined an ambitious 2050 Strategy and "Five Social Initiatives" for the development of Kazakhstan.⁵⁹ These initiatives include an improved mortgage program, a reduced personal income tax rate for low-income earners, accessibility to higher education, expanded microcredits, and a new gas pipeline to reduce reliance on coal-fired power plants.^{60, 61, 62, 63}

Central to ensuring the balanced development of Kazakhstan will be policy dedicating greater resources to small and medium-sized enterprises (SMEs). A current deposit insurance policy structure has pledged National Bank coverage of investor funds lost with the default of Kazakhstani banks. While this policy quelled investor concerns in the early days of Kazakhstan's development, the overzealous commitment has inappropriately saddled the national government with large debts that detract from its ability to promote the growth of SMEs.^{64, 65}

The Tokayev Administration is not unwilling to commit to financially questionable projects. Plans for a light rail system to reduce congestion in Nur-Sultan have recently been postponed indefinitely after the Bank of Astana was dissolved, leading the China Development Bank (CDB) to stop providing funding to the \$1.9 billion project.⁶⁶ The Chinese funds, which were deposited into the Bank of Astana by state-owned TOO Astana LRT, are reported to have not been properly allocated by Astana LRT towards the railway project.

A more robust vetting process for the approval of PPPs that would focus funding on the most necessary of projects would build faith in government partnerships while also freeing funds for dedication to SMEs. While the Kazakhstani government has established a general framework for the preparation of PPPs, insufficiently detailed regulation has led to the approval of less than reasonable pursuits, leading to fiascos such as the light rail project.⁶⁷ Clearly defining grounds for both formation, launch, performance, and completion builds trust for a PPP project's stakeholders thereby decreasing risk premiums and increasing project value.⁶⁸

Overall, the financial system in Kazakhstan has improved with the relative reduction of state control in

⁵⁹ "The Challenge of Economic Diversification Amidst Productivity Stagnation." *World Bank in Kazakhstan*. Fall 2018. Accessed June 28, 2019. <http://pubdocs.worldbank.org/en/265701543402099127/Kazakhstan-Economic-Update-Fall-2018-en.pdf>, pp. 15.

⁶⁰ *Ibid.*, pp. 5.

⁶¹ "2018 Article IV Consultation – Press Release; and Staff Report." *International Monetary Fund*, September 2018, pp. 7.

⁶² "Five Social Initiatives of President Nursultan Nazarbayev." *Embassy of the Republic of Kazakhstan to the Kingdom of Belgium*. March 7, 2018. Accessed June 28, 2019. <http://www.mfa.gov.kz/en/brussels/content-view/five-social-initiatives-of-president-nursultan-nazarbayev>.

⁶³ "Kazakhstan 2050 Strategy." *Embassy of the Republic of Kazakhstan in the Italian Republic*. February 14, 2018. Accessed June 28, 2019. <http://mfa.gov.kz/en/roma/content-view/strategia-kazahstan-2050-14>.

⁶⁴ Akash Deep. "Financial Sector Reform in Kazakhstan." *Center for International Development at Harvard University*. 2011. https://growthlab.cid.harvard.edu/files/growthlab/files/kazakhstan_strategy_and_policy_2005.pdf#page=58, pp. 56.

⁶⁵ OECD. "Reforming Kazakhstan: Progress, Challenges and Opportunities." *OECD Publishing*. 2017. Pg. 23.

⁶⁶ Nariman Gizitdinov. "China's \$1.9 billion Belt and Road Rail Project Goes Off Track" *Bloomberg*. June 3, 2019. <https://www.bloomberg.com/news/articles/2019-06-03/china-s-1-9-billion-silk-road-rail-project-goes-off-track>

⁶⁷ "Procuring Infrastructure Public-Private Partnerships Report." *International Bank for Reconstruction and Development / The World Bank*. 2018, pp. 139.

⁶⁸ *Ibid.*, pp. 61.

the economy. With economic and social reform, Kazakhstan has attracted \$4.6 million of FDI inflow in 2017 and is ranked 28th in the World Bank's *Doing Business Report 2019* and first in "Protecting Minority Investors."^{69, 70} The government must now maintain proper management over the business environment to sustain the inflow of FDI that will support a modern infrastructure environment.⁷¹

Recommendations:

- **Adopt PPP Standards:** In 2017, the government with assistance from the World Bank, adopted a new 2018-2022 National Investment Strategy to boost total FDI inflows by 25% by 2022.⁷² To implement it, the country must develop more detailed standards guiding the approval of PPPs and specifying the criteria for their completion.
- **Utilize the AIFC:** Kazakhstan should leverage its new financial institution, the AIFC, to act a "gatekeeper" for PPPs to vet potential partners and offer financial incentives to highly desirable projects. The AIFC should also play a role in promoting Kazakhstan's twelve special economic zones (SEZs) which provide tax, regulatory, and financial benefits for outside businesses who operate within SEZ borders.
- **Crack Down on Corruption:** Restore investor confidence in the anti-corruption campaign announced as part of "Kazakhstan 2050" by openly punishing high-level perpetrators.

B. Uzbekistan

Uzbekistan is on a promising path of reforms with the country now transitioning away from authoritarian political and economic rule towards a more market-oriented system. The reform process – which began in 2017 and now commonly known as the "Tashkent Spring" – aims to promote democratic values and voter participation, encourage economic integration, and expand anti-corruption legislature.

As part of these reforms, Uzbekistan's growth has benefited from further regional integration promoted by the country's noteworthy foreign and economic policy adjustments.⁷³ President Mirziyoyev has opened Uzbek borders to facilitate direct trade with neighbors and has collaborated with regional partners and peers to resolve long-standing issues related to water, energy, transportation, trade, and regional economic development.⁷⁴

While the current political system in Uzbekistan is still in its early stages of democratic institutional

⁶⁹ "2019 Index of Economic Freedom: Kazakhstan." *The Heritage Foundation*. 2019. <https://www.heritage.org/index/country/kazakhstan>

⁷⁰ "Doing Business 2018: Training for Reform." *World Bank Group*. 2019. https://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf

⁷¹ Williams, Anthony. "EBRD forum in Beijing to promote investment in Central Asia." *European Bank for Reconstruction and Development*. November 9, 2018.

⁷² "Kazakhstan," *U.S. Department of State*. 2018. <https://www.state.gov/reports/2018-investment-climate-statements/kazakhstan/>

⁷³ "Regional Economic Outlook Update." *International Monetary Fund*. April 2019. Accessed June 28, 2019. [https://www.elibrary.imf.org/abstract/IMF086/25418-9781484375389/25418-9781484375389/binaries/Caucasus_and_Central_Asia_\(CCA\)_Apr_19_Update.pdf?redirect=true&redirect=true](https://www.elibrary.imf.org/abstract/IMF086/25418-9781484375389/25418-9781484375389/binaries/Caucasus_and_Central_Asia_(CCA)_Apr_19_Update.pdf?redirect=true&redirect=true), pp. 6.

⁷⁴ Paul Stronski. "On Central Asia's Big Questions." *Carnegie Endowment for International Peace*. November 20, 2018. Accessed June 28, 2019. <https://carnegieendowment.org/2018/11/20/on-central-asia-s-big-questions-pub-77766>.

development, the Mirziyoyev administration continues to implement important governmental reforms to ensure investor confidence, particularly in the justice sector and security services, and funding infrastructure development.⁷⁵ On January 4, 2017 the law “On Combating Corruption” went into effect, and in 2018, the Government implemented a broad range of anti-corruption policies across 65 government agencies, ministries and organizations.^{76, 77} Additional anti-corruption plans are underway for specific economic sectors and public administrations to further ameliorate the business climate in Uzbekistan, which has risen from 87th place in 2016 to 76th place in 2019 in the World Bank ‘Ease of Doing Business’ ranking.⁷⁸ Anti-corruption efforts are the primary driver of this rise.

Uzbekistan has further improved the business climate by passing the Law “On Public-Private Partnership” in May of 2019 – signaling a further commitment to addressing its infrastructure needs.⁷⁹ Reforms in 2017 that removed foreign currency barriers have also improved the overall business climate and exposed Uzbekistan to the global market.⁸⁰

Yet, mounting social inequalities and economic weaknesses are obstacles to both immediate and long-term infrastructure development goals. In particular, labor mobility and limited job prospects at home – despite rising youth populations – have left the country short of the human capital resources necessary to reinvigorate the economy.⁸¹

As noted by the World Bank, poor internal labor mobility worsens spatial (regional) differences in income, concentrating economic activity in leading districts and major cities.⁸² Consequently, workers of Uzbekistan’s western districts have limited access to the areas of strongest growth in the eastern districts.⁸³

⁷⁵ Ibid.

⁷⁶ “Law of the Republic of Uzbekistan: On Combatting Corruption.” *LexUZ*. January 4, 2017. Accessed June 28, 2019. <http://www.lex.uz/docs/4056495>.

⁷⁷ “Fighting Corruption in Eastern Europe and Central Asia: Anti-Corruption Reforms in Uzbekistan.” *Organisation for Economic Cooperation and Development*. 2019. Accessed June 28, 2019.

⁷⁸ “Doing Business 2019.” *World Bank Group*. 2019. Accessed June 28, 2019. https://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf, pp. 5.

⁷⁹ “New Opportunities for Public-Private Partnership.” *United Nations Development Programme*. May 23, 2019. <http://www.uz.undp.org/content/uzbekistan/en/home/presscenter/articles/2019/05/23/new-opportunities-for-public-private-partnership.html>

⁸⁰ “Uzbekistan Reforms for a Sustainable Transformation Toward a Market Economy Development Policy Operation.” *The World Bank*. May 29, 2018. <http://documents.worldbank.org/curated/en/554291530243050278/pdf/Uzbekistan-Reform-PD-06042018.pdf>, pp. 18.

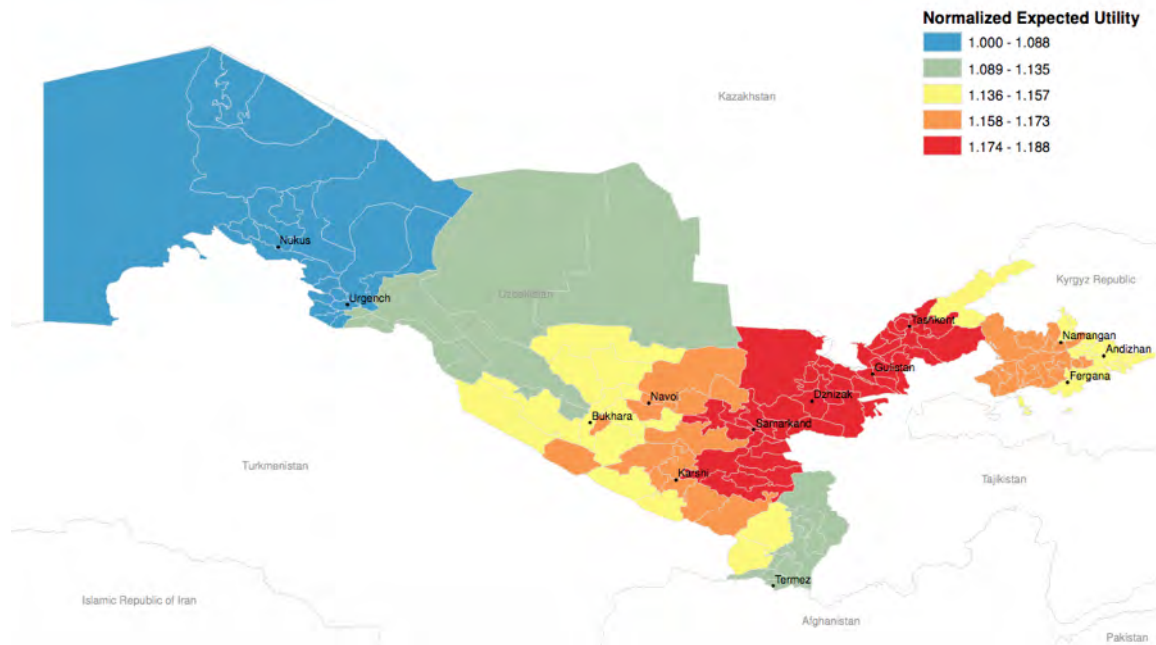
⁸¹ Paul Stronski. “On Central Asia’s Big Questions.” *Carnegie Endowment for International Peace*, November 20, 2018.

⁸² Ibid., pp. 77

⁸³ Belt and Road Economics: Opportunities and Risks of Transport Corridors.” *World Bank Group*. 2019. Accessed June 28, 2019. <https://openknowledge.worldbank.org/bitstream/handle/10986/31878/9781464813924.pdf>, pp. 94.

Figure 8. Uzbekistan

Expected utility is highest in Jizzah, Samarqand, Sirdaryo, Surxondaryo, and Tashkent.



Source: The World Bank⁸⁴

The spatial inequality illustrated above is a consequence of inadequate transportation infrastructure, and underdeveloped financial operations. The majority of Uzbeks are physically and digitally isolated from economic opportunities, lacking access to adequate transportation and telecommunication services such as cellular service and the Internet. Thus, income growth will remain concentrated in urban centers, leaving rural populations impoverished, underserved, and underdeveloped if not addressed. In addition to a lack of hard transportation infrastructure, burdensome government regulations surrounding property rights make it difficult for citizens to relocate from rural to urban areas.⁸⁵ It would therefore behoove Uzbek policymakers to implement infrastructure development programs for these isolated locations which aim to increase social and economic connectivity.⁸⁶

Furthermore, the Mirziyoyev Administration should continue addressing corruption and mismanagement. It should enforce greater accountability for local officials in resolving regional, local, and community problems, which would assist with equitable distribution of development in the country.⁸⁷ Improving local governance and labor mobility would reduce the cost of internal migration, in turn increasing the overall welfare of Uzbeks.⁸⁸

⁸⁴ Somik Vall and Mathilde Lebrand. "Who Wins, Who Loses? Understanding the Spatially Differentiated Effects of the Belt and Road Initiative." *The World Bank Group*. April 2019. <http://documents.worldbank.org/curated/en/292161554727963020/pdf/Who-Wins-Who-Loses-Understanding-the-Spatially-Differentiated-Effects-of-the-Belt-and-Road-Initiative.pdf>, pp. 38.

⁸⁵ Somik Vall and Mathilde Lebrand. "Who Wins, Who Loses? Understanding the Spatially Differentiated Effects of the Belt and Road Initiative." *The World Bank Group*. April 2019, pp. 8.

⁸⁶ *Ibid.*, pp. 95.

⁸⁷ Paul Stronski. On Central Asia's Big Questions. *Carnegie Endowment for International Peace*. November 20, 2018.

⁸⁸ "Belt and Road Economics: Opportunities and Risks of Transport Corridors." *World Bank Group*. 2019, pp. 94.

Outside of spatial inequality issues, the country also suffers from a mismanaged financial sector. The banking system in Uzbekistan is threatened by improper administration, which undermines investor confidence and slows income growth among the civilian population.⁸⁹ Unsatisfactory loan underwriting standards, poor payment culture, and inadequate rule of law constrain lending, thereby inhibiting financial operations of economic development, including infrastructure projects.⁹⁰

Establishing financial and banking regulatory frameworks would improve “underwriting standards and credit risk management, better corporate governance in banks, and strengthen the judiciary and legal systems to enhance the rule of law”, ultimately easing once limited financing opportunities.⁹¹

Despite domestic financial weaknesses, several international institutions, such as the Asian Development Bank (ADB), have been assisting Uzbekistan through early growth pangs by committing billions of dollars to the country. Since joining the ADB in 1995, Uzbekistan has received 70 loans amounting to \$7.4 billion to assist in sustainable economic growth and to strengthen governance.⁹² The ADB will continue to explore opportunities for direct investment via public-private partnerships and private sector projects.⁹³ Although, the ADB has been unable to tackle the deep-rooted lack of transportation and communication infrastructure as the country is facing soft infrastructure shortcomings.

To fill infrastructure gaps and to maintain foreign investors’ interest, Uzbekistan will have to overhaul banking and financial regulations, and prioritize the stabilization of inflation rates.⁹⁴ Setting a floating currency exchange rate and inflation targets through the Central Bank will add another degree of confidence for those seeking to do business in Uzbekistan. As the Central Bank currently controls 85% of Uzbek banking system’s total asset pool, an increase in private debt ownership would further mitigate inflation-related volatility that often discourages foreign investment in infrastructure development.⁹⁵

Overall, Uzbekistan has introduced a measured approach to reform that should produce sustainable development in the region. The government has implemented robust market reforms that have streamlined taxation and boosted the private sector. However, there is a crucial need for industry diversification, banking sector reforms and improvements in the labor market. Severe spatial inequalities must also be addressed through combination of hard and soft infrastructure development designed to integrate rural populations with urban centers.

⁸⁹ “Regional Economic Outlook Update.” *International Monetary Fund*. April 2019. [https://www.elibrary.imf.org/abstract/IMF086/25418-9781484375389/25418-9781484375389/binaries/Caucasus_and_Central_Asia_\(CCA\)_Apr_19_Update.pdf?redirect=true&redirect=true](https://www.elibrary.imf.org/abstract/IMF086/25418-9781484375389/25418-9781484375389/binaries/Caucasus_and_Central_Asia_(CCA)_Apr_19_Update.pdf?redirect=true&redirect=true), pp. 7.

⁹⁰ “Regional Economic Outlook Update.” *International Monetary Fund*. April 2019. [https://www.elibrary.imf.org/abstract/IMF086/25418-9781484375389/25418-9781484375389/binaries/Caucasus_and_Central_Asia_\(CCA\)_Apr_19_Update.pdf?redirect=true&redirect=true](https://www.elibrary.imf.org/abstract/IMF086/25418-9781484375389/25418-9781484375389/binaries/Caucasus_and_Central_Asia_(CCA)_Apr_19_Update.pdf?redirect=true&redirect=true), pp. 7.

⁹¹ *Ibid.*, pp.12

⁹² “Asian Development Bank and Uzbekistan.” *Asian Development Bank*. April 2019. <https://www.adb.org/publications/uzbekistan-fact-sheet>.

⁹³ *Ibid.*

⁹⁴ Lagarde, Christine. “Uzbekistan’s Reforms: A New Equation for Inclusive Growth and Cooperation.” *International Monetary Fund*. May 17, 2019. Accessed June 28, 2019. <https://www.imf.org/en/News/Articles/2019/05/17/sp051719-lagarde-uzbekistan-reforms-a-new-equation-for-inclusive-growth-and-cooperation>.

⁹⁵ *Ibid.*

Recommendations:

- **Labor/social reforms:** The Uzbek government and The World Bank have partnered to form a project focused on providing educational opportunities to underdeveloped communities.⁹⁶ Further reforms must be aimed at education and social welfare programs to develop skill sets to improve employment, promote economic growth, and address spatial labor inequalities. Initiatives, such as improving educational opportunities, promoting women in the workforce by introducing policy that allows for flexible work schedules, and engaging the growing youth population would provide lasting economic and social benefits. Removing additional barriers to labor mobility on the administrative, housing/credit market, and hard infrastructure side must also be prioritized.
- **Industry diversification:** The majority of foreign investment is directed towards commodities such as oil and cotton. On a positive note, some investment in the power sector is taking place. Like other countries in the region highly reliant on natural resources, Uzbekistan must encourage investment and growth in its underdeveloped industries (particularly labor-intensive industries such as agriculture, mining, industrial, etc.).
- **Banking sector:** More than 80% of the banking sector remains under state control and is underdeveloped and inefficient, making it difficult for private companies to receive loans or credits. Introducing reforms that would increase the banking and finance industry privatization rates above 50% and simultaneously achieve international finance standards would increase domestic and foreign confidence in the sector. To accomplish this along with other reform goals, personnel from other countries should be allowed to work in the countries that undergo vital transformation.

C. Turkmenistan

Turkmenistan is the third largest economy in the region and home to the world's fourth largest natural gas reserves.⁹⁷ The economy is heavily controlled by the state and significantly relies on hydrocarbon resources, with hydrocarbon revenues accounting for up to 25% of GDP.⁹⁸ While FDI totaled \$16 billion from 2003-2016, the majority of this investment targets the natural resources industry.⁹⁹ Other sectors such as agriculture, textiles, food and clothing, need investment and reforms in order to contribute to the economy. However, corruption, inefficient property rights, and heavy bureaucracy are crimping development.¹⁰⁰ Lack of transportation infrastructure (aside from gas pipelines) also leaves Turkmenistan isolated from regional markets and global trade.

The authoritarian government has largely resisted liberal reforms that would loosen its grip on the economy and invite market competition. The private sector is very limited, making up less than 20% of

⁹⁶ "Investing in Children means Investing in Uzbekistan's Future." *The World Bank*. March 16, 2018. <https://www.worldbank.org/en/news/feature/2018/03/16/investing-in-children-means-investing-in-uzbekistans-future>

⁹⁷ "Investing in Central Asia: One Region, Many Opportunities." *Boston Consulting Group*. December 2018. https://www.bcg.com/Images/BCG-Investing-In-Central-Asia-report-ENG_tcm26-212857.pdf. pp. 32.

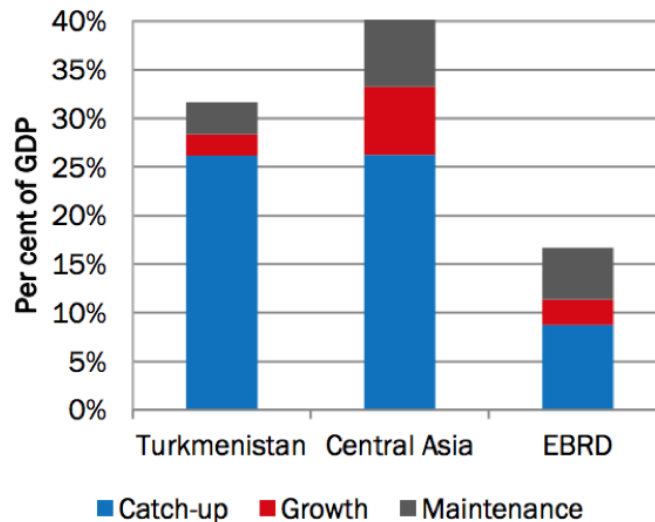
⁹⁸ "Investing in Central Asia: One Region, Many Opportunities." *Boston Consulting Group*. pp. 32.

⁹⁹ *Ibid.*, pp. 32.

¹⁰⁰ *Ibid.*, pp. 33.

the country's economy.¹⁰¹ Additionally, the government does not make country data readily available to the public, making it difficult to bring in foreign investment and accurately analyze the business climate. Trade and access to the global market is problematic due to the government's restrictions on currency exchange and government-imposed limitations on currency conversion.¹⁰² Transportation, infrastructure, and customs complications further discourage foreign investment in the country.

Figure 9: Infrastructure Investment Needs 2018-2022



Source: EBRD¹⁰³

Turkmenistan remains a challenging environment for public-private partnerships. Reforms to foster private sector growth, such as bringing international standards to Turkmenistan, have been introduced, but with little success.¹⁰⁴ The country suffers from a lack of property rights protection that hinders public-private partnerships. Project proposals from private businesses have to be approved by the Union of Industrialists and Entrepreneurs (UIET) to receive resources such as land, loans, and infrastructure.

Current investment and infrastructure schemes in Turkmenistan focus on natural resources and are exemplified by the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline project that dates back to the 1990s, viewed as an alternative to a proposed pipeline between Iran, Pakistan and India.¹⁰⁵ Modernization in the technology and telecommunications sectors is needed due to poor connection and low internet availability that hinders investment and foreign interest. Turkmenistan has secured an agreement with the Islamic Development Bank for \$237 million to finance its telecommunications network.¹⁰⁶

¹⁰¹ "Turkmenistan – Market Overview." *Export.gov*. Last published February 14, 2019. <https://www.export.gov/article?id=Turkmenistan-Market-Overview>

¹⁰² "Turkmenistan – Market Overview." *Export.gov*.

¹⁰³ *Ibid.*, pp. 23.

¹⁰⁴ Hans Holzhaecker and Dana Skakova. "Turkmenistan Diagnostic." *European Bank for Reconstruction and Development*. May 2019. <https://www.ebrd.com/documents/policy/country-diagnostic-paper-turkmenistan.pdf?blobnocache=true>, pp. 11.

¹⁰⁵ Lisa Curtis, Ariel Cohen and Owen Graham. "The Proposed Iran-Pakistan-India Gas Pipeline: An Unacceptable Risk to Regional Security." *The Heritage Foundation*. May 30, 2008. <https://www.heritage.org/asia/report/the-proposed-iran-pakistan-india-gas-pipeline-unacceptable-risk-regional-security>

¹⁰⁶ Hans Holzhaecker and Dana Skakova. "Turkmenistan Diagnostic." *European Bank for Reconstruction and Development*, pp. 11.

To promote foreign direct investment and public-private partnerships, Turkmenistan must modernize and reform its regulatory and legal framework in several ways. State-controlled companies have created an environment of monopolies in Turkmenistan, hindering competition and deterring private sector growth.

The privatization of industries will create a more open economy and reduce governmental influence in business practices. Most importantly, diversification of the economy is essential for Turkmenistan, given its reliance on natural resources as a source of revenue and growth. Instability brought by commodity prices, including natural gas, leaves Turkmenistan vulnerable and the government should work towards attracting investment to underdeveloped sectors.

China provides financing for energy and transport infrastructure and remains the main source of revenue for Turkmenistan through gas exports. Increasing regional cooperation will facilitate cross-border infrastructure and provide Turkmenistan with added gas markets that it desperately needs to bring in additional foreign currency and avoid reliance on a single market. With the agreement on the legal status of the Caspian Sea, Turkmenistan can now resume discussions regarding the proposed Trans-Caspian pipeline which would bring Turkmen gas to Azerbaijan and on to the larger European market via Trans-Anatolian Pipeline and Trans-Adriatic Pipeline (TAP/TANAP).

The need for infrastructure in Turkmenistan is great – without a favorable business environment that encourages investment, the country will continue to lag behind. Turkmenistan would need to spend an estimated 31.7% of its annual GDP from 2018-2022 on maintaining and building infrastructure in order to reach the spending level of advanced countries (see Figure 9: *Infrastructure Investment Needs 2018-2022*).¹⁰⁷ This type of growth is near impossible to achieve without assistance from FDI, private sector investment, and support from development banks.

Turkmenistan can learn from Kazakhstan and Uzbekistan, both of which are implementing reforms that have led to quantifiably improved business environments and higher living standards. Reforms in these two countries have improved investor attractiveness by restricting business requirements, easing land and construction permits and reducing the bureaucratic barriers that slowdown or complicate investment.¹⁰⁸ An open economy that brings investment to non-hydrocarbon sectors is critical to ensure sustainable growth in the future.

Recommendations:

- **Transparency:** In order to gain investor confidence and attract much-needed foreign investment, Turkmenistan must promote transparency, particularly by sharing financial and economic data. Government economic decisions must be made public and subject to inspection and investigation, including by the media, the NGO sector, international financial institutions, etc.
- **Private sector growth:** Reforms of the legal framework and institutions of the national economy, to encourage a market-based approach and adopt international standards for business operations would draw private sector participation. The state-controlled economy must also begin the painful but necessary unbundling of government monopolies, particularly those in the energy sector.

¹⁰⁷ Ibid., pp. 23.

¹⁰⁸ "Investing in Central Asia: One Region, Many Opportunities." Boston Consulting Group. December 2018, pp. 20

- **Diversification:** Turkmenistan is highly dependent on natural gas revenues to support its economy, and is heavily reliant on payments from a single customer, China. Growth in other industries is vital in providing the country with sustainable growth. However, without basic institutional mechanisms such as a corpus of modern economic legislation, a cadre of economists, lawyers, accountants/ auditors, etc., without transparency, an open economy and rule of law, growth in other industries would be difficult to achieve without foreign investment.

D. Tajikistan

Tajikistan is in need of substantial reform across all sectors. With a population of 9 million and a GDP of approximately \$7.5 billion, the country consistently ranks as one of the least developed in all of Eurasia.¹⁰⁹ Anemic infrastructure development, poor government policy frameworks, and massive corruption and national debt are just some of the development challenges facing the country.¹¹⁰ It may also be slowly changing its geopolitical orientation. In 2017 China overtook Russia as the largest source of foreign direct investment, most of which is committed to the financing of connective infrastructure like roads, bridges, and power plants for BRI.

Declining prospects in Tajikistan are the consequence of continued fiscal consolidation, which compounds pressure from lower remittances— a primary source of gross domestic product, as the Russian economy is stagnating.¹¹¹ The majority of Tajik migrant workers work in Russia. Moreover, the country has to allocate a considerable percentage of its financial resources to import oil and gas, lacking the massive hydrocarbon reserves of Kazakhstan or Turkmenistan. Recent growth in Tajikistan has been largely due to international loans via Chinese BRI funding for natural resources extraction. Tajikistan owes 50% of its public debt to China, and BRI commercial loan repayments will exacerbate the hazards of debt distress for the low income nation.^{112, 113} As a form of debt repayment, Tajikistan is gradually signing away land and mining rights. In 2011, the Tajikistani government ceded 1,100 square kilometers of land near the Afghan border to China. It appears that the Tajik governments is betting on economic growth rates outpacing the growth in debt repayments – a risky proposition when global recession seems more likely for 2019 and 2020.

Another major issue is that Public Private Partnerships – a crucial pillar of successful high capital expenditure infrastructure projects -- are largely absent from Tajikistan’s development. While the government has loudly promoted PPPs as a fast track to development, it has failed to genuinely pursue implementation for projects outside of natural gas distribution. The Pamir Power Project, for example, has been lauded as a successful example of domestic PPP success. The arrangement established a tariff system through which lower electricity usage for residential customers paid a minimal fee for electricity compared to higher usage customers, simultaneously increasing energy access and revenues from power production. The partnership between the International Finance Corporation, the World Bank International

¹⁰⁹ “Tajikistan.” *World Bank*. 2019. Accessed July 5, 2019. <https://data.worldbank.org/country/tajikistan>.

¹¹⁰ “Tajikistan GDP”: <https://tradingeconomics.com/tajikistan/gdp>, April 2019.

¹¹¹ “Regional Economic Outlook Update.” *International Monetary Fund*. April 2019, pp. 3.

¹¹² “Belt and Road Economics: Opportunities and Risks of Transport Corridors.” *World Bank Group*. 2019. <https://openknowledge.worldbank.org/bitstream/handle/10986/31878/9781464813924.pdf>, pp. 101.

¹¹³ Ariel Cohen. “As Global Markets Cool, Investors Find Warmth in Central Asia’s Infrastructure.” *Forbes*. December 12, 2018. Accessed June 28, 2019. <https://www.forbes.com/sites/arielcohen/2018/12/12/as-global-markets-cool-investors-find-warmth-in-central-asias-infrastructure/#36e9a1e2624e>.

Development Association, and outside donors exemplifies consistent cooperation despite the endeavor's high financial risk.¹¹⁴ This arrangement facilitated low-income regions with affordable power at little cost to the federal government.

However, Pamir is the exception to the rule in Tajikistan. The majority of the handful of PPPs projects in the country have failed, including the Dushanbe-Chanak Highway project. In 2010, the government transferred maintenance of the toll road which connects Dushanbe to Chanak to a private company: Innovative Road Solutions. The project was awarded without proper registration according to Tajik law. As is the case with many domestic PPPs, financial transparency was lacking and the project timeline was not adequately communicated to the public. The economic viability of the Dushanbe-Chanak Highway project remains uncertain and the Government of Tajikistan is responsible for the risk of associated loan repayments.¹¹⁵ This case, like the others, suggests that both the legal base for investment in general and PPPs in particular need to be improved and upgrade, the relevant law and the regulation rewritten, and government personnel in charge of investment, retrained.

The lack of transparency, poor legislative and regulatory base, and insufficient licensing practices are not the only obstacles facing the low income nation. Tajikistan's financial system suffers from poor regulatory and governance frameworks. Practices such as currency lending to unprotected borrowers and nonviable banks are easy-to-define issues that have serious compounding effects for development, primarily via unacceptable lending risks/rates.

However, lower inflation rates have created the opportunity for monetary policy reform in Tajikistan, as the country has implemented a managed floating exchange rate regime to boost competitiveness.¹¹⁶ While this is a positive development, existing policy frameworks are incapable of setting accurate inflation rate expectations, which hurts the long term prospects of a flexible exchange rate system. To further improve capital market development for infrastructure investment in Tajikistan, the International Monetary Fund (IMF) recommends "developing adequate monetary instruments and forecasting capabilities."¹¹⁷ This is a tall order in a country with severe skills shortages.

Filling gaps in data and facilitating communication between fiscal authorities would then allow for stronger relations between the Central Bank, the financial sector, and domestic stakeholders stabilizing inflation expectations, and hopefully attracting a diversified pool of foreign investors.¹¹⁸ The government must also enhance budget transparency if the country is to attract more favorable foreign investment.¹¹⁹ While Tajikistan does require and publish International Financial Reporting Standards audits, fiscal governance is not as strong as neighboring Kazakhstan or Kyrgyzstan, which are also struggling far less

¹¹⁴ Ziyodullo Parpiev. "Is public-private partnership a solution to the infrastructure backwardness of Tajikistan?" *Westminster International University in Tashkent*. November 30, 2018. <https://www.carecinstitute.org/wp-content/uploads/2018/12/2018-AST-PRES-Is-public-private-partnership-a-solution-to-the-infrastructure-backwardness-of-Tajikistan.pdf>.

¹¹⁵ Ibid.

¹¹⁶ "Tajikistan: Strong Growth with a Challenging Outlook." *World Bank Group*. Spring 2017. <http://documents.worldbank.org/curated/en/699491500886178530/pdf/117706-WP-ECA2017-TJK-PUBLIC-ENGLISH.pdf>, pp. 12.

¹¹⁷ Ibid., pp. 13-14.

¹¹⁸ Ibid., pp. 13-14.

¹¹⁹ "Promoting Inclusive Growth in the Caucasus and Central Asia." *International Monetary Fund*, 2019, pp. 23.

with attracting infrastructure financing.¹²⁰

Tajikistan must be proactive in leveraging regional investment opportunities with fiscal policy reforms, fighting corruption, and strategic planning, as it proceeds with its development. High level graft, BRI related debt, and a dysfunctional banking sector will continue to damage the country's ability to secure favorable loan agreements. These circumstances oblige Tajikistan to rely on grants or highly concessional financing that inhibit infrastructure development.¹²¹

Recommendations:

- **PPP oversight:** A government institution or agency tasked with evaluating PPPs for feasibility is required. Responsibilities of this new body would include establishing clear guidelines for PPP success, limiting project scope, establishing a timeline, and connecting parties with adequate sources of financing.
- **Budgetary and Business Transparency:** Clear reporting lines and inter-agency coordination guidelines, possibly inviting international audit firms to conduct the work, must be established and enforced to reduce corruption and improve public confidence.
- **Debt Management:** Tajikistan faces significant debt hazards as more than 50% of its public debt are owed to China at non-conciliatory rates, forcing the country to sell-off land and natural resource leases. The country should consider raising domestic tax rates to increase revenue for repayment or negotiate lower interest rate loans with global financial institutions such as the World Bank to repay higher interest Chinese obligations.

E. Kyrgyzstan

Kyrgyzstan has struggled to transition to a democratic system of government since its independence in 1991. The mountainous and landlocked nation is marred by chronic instability, systemic corruption, and substantial poverty. There have been two revolutions in the country since 2005, the first of which was the so-called "Tulip Revolution" wherein President Askar Akayev was ousted from power following mass protests against regime authoritarianism and corruption. In April of 2010, President Kurmanbek Bakiyev – Akayev's successor – was forced out of power after protestors took control of the capital Bishkek. Government corruption and increased living expenses were the primary drivers of the civil unrest where 80 were killed and almost 500 were hospitalized.

Political turmoil is still a part of everyday life in Kyrgyzstan. In August of 2019, President Sooronbay Jeenbekov raided the home of former political ally and President Almazbek Atambayev (2011 – 2017) and detained him under charges of corruption. Atambayev's supporters clashed with police in Bishkek over the government action, which they called political retribution.¹²²

¹²⁰ Ibid., pp. 23.

¹²¹ Ibid., pp. v.

¹²² Andrew Roth. "Kyrgyzstan's former president detained after violent clashes," *The Guardian*. August 8, 2019. <https://www.theguardian.com/world/2019/aug/08/kyrgyzstan-ex-president-almazbek-atambayev>

Political issues are not the only obstacles to Kyrgyzstan's soft infrastructure development. The formal labor market has not been fully developed, and a large percentage of its GDP – between 23% and 40% – operates in an unregulated and untaxed “shadow economy.”¹²³ Over 25% of the population lives below the poverty line.¹²⁴ These issues compound to create larger operational and logistical risks for public infrastructure projects in comparison to the other Central Asian countries.¹²⁵ Overall, the combination of these obstacles has resulted in an unwillingness among foreign investors to provide much-needed capital for the country's severe hard and soft infrastructure needs.

Chief among Kyrgyzstan's infrastructure failures is the absence of adequate and reliable power generation. Despite massive hydroelectric power potential – estimated at 140-170 TWh – only 10% has been exploited.¹²⁶ The country's seven major hydropower plants account for 93% of total domestic demand, five of which exceed 30 years in age.¹²⁷ Subsequently, aging and poorly managed energy infrastructure has led to major countrywide issues.

This situation is best illustrated by the Bishkek power outage in January 2018 – where residents of the capital lost power in the dead of winter for several days. In 2013, a Chinese company with minimal past experience was awarded the bid for the power plant project.¹²⁸ Systematic levels of corruption, bribery and rigged bidding associated with the financing of the city's power plant were to blame, costing the country an estimated \$11 million.¹²⁹ Blackouts continue to be a common occurrence in the rural areas of Kyrgyzstan.^{130, 131}

Beyond Kyrgyzstan's aging power sector, inadequacies extend to other basic infrastructure needs. Roads, airports, railways, bridges, canals, and other pillars of infrastructure are degrading at a rate greater than that of its CAR neighbors.¹³² Kyrgyz Republic needs major capital investment initiatives, ideally in the form of FDI, to come up to par with its regional neighbors.

Bishkek has actively attempted to stimulate power projects and other infrastructure development in the region via multiple government-funded initiatives. The Kyrgyz government has taken roughly \$1.7 billion in loans from China to build roads, railways, and other necessary energy projects, with these

¹²³ “Current Condition of FDI in Kyrgyzstan.” *Kabar Information Agency*. Accessed July 10, 2019. <https://kabar.kg/eng/news/current-condition-of-fdi-in-kyrgyzstan/>.

¹²⁴ Ibid.

¹²⁵ “Kyrgyz Republic.” *Kyrgyz Republic Economy: Population, GDP, Inflation, Business, Trade, FDI, Corruption*. Accessed July 10, 2019. <https://www.heritage.org/index/country/kyrgyzrepublic>.

¹²⁶ “Kyrgyzstan Country Profile,” *International Hydropower Association*. Accessed July 23, 2019 <https://www.hydropower.org/country-profiles/kyrgyzstan>

¹²⁷ Ibid.

¹²⁸ Andrew Higgins. “A Power Plant Fiasco Highlights China's Growing Clout in Central Asia.” *The New York Times*. July 6, 2019.

¹²⁹ Ibid.

¹³⁰ Ibid., pp. 118.

¹³¹ Catherine Putz. “Bitter Cold Hits Bishkek, Chinese-Repaired Power Plant Breaks Down.” *The Diplomat*. January 30, 2018. Accessed July 10, 2019. <https://thediplomat.com/2018/01/bitter-cold-hits-bishkek-chinese-repaired-power-plant-breaks-down>.

¹³² “Country Partnership Strategy: Kyrgyz Republic.” *Asian Development Bank*. Accessed April 2019. <https://www.adb.org/sites/default/files/institutional-document/33943/files/cps-kgz-2013-2017.pdf>

loans now comprising almost 50% the state's public debt.¹³³, ¹³⁴ Talks between Kyrgyzstan and China have been underway to build a railroad connecting China through Kyrgyzstan, Uzbekistan, to Turkmenistan.¹³⁵ Kyrgyzstan finds itself in a precarious situation – desperately needing infrastructure development but unable to responsibly take on the additional debt it would require.

While the other post-Soviet republics like Kazakhstan have been able to shift their focus to trade between Europe and China via BRI, Kyrgyzstan has not been so successful. The country's dilapidated infrastructure and sluggish development since the end of the Cold War has left its Soviet era transport networks oriented towards North-South trade rather than East-West. In order for the Kyrgyz Republic to succeed, it must develop an East-West infrastructure strategy to take advantage of both BRI initiatives and to facilitate trade with both regional states and the global market. However, strong institutions and a legal framework must be present the Kyrgyz Republic to benefit, socially and economically, from the options offered by additional BRI infrastructure development.

The country has significant potential in both agricultural and natural resources, with large swathes of arable land (7% of the country) and areas for grazing of livestock (48%).¹³⁶ The agricultural sector, in particular, could prove to be a sustainable source of revenue for its economy provided that proper expertise, training, and management are fostered in the industry, according to the World Bank Group.¹³⁷ Currently, the Kyrgyz economy remains largely dependent on its domestic gold mining industry and economic migrants' remittances from the Russian Federation. Revenue from gold exports range from 8-10% of the nation's GDP, while it is estimated that over 27% of the nation's GDP in 2018 came via remittances.¹³⁸

Infrastructure projects are typically plagued by corruption, costly delays and unpredictable enforcement of the law. The Kumtor gold mine for instance, the single largest source of FDI in the country, has continued to suffer from corruption scandals due to political instability. In 2015, a former executive of the Canadian shareholder of the mine, Centerra Gold Inc., was arrested at the request of the Kyrgyz Ministry of Justice. Prosecutors claimed that a multi-million dollar restructuring deal from 2004 was approved under corrupt government officials in power at the time, citing Centerra as a guilty party.¹³⁹

To mitigate investor uncertainty as demonstrated in the Kumtor gold mine case, the government is taking steps to reduce the complexity of its tax regime, remove red tape, and increase transparency of PPP laws. The first public-private partnership (PPP) legislation was passed in 2018 and has already seen success in the medical sector, with a 10-year PPP agreement for dialysis clinics across the country. Though a small

¹³³ Andrew Higgins. "A Power Plant Fiasco Highlights China's Growing Clout in Central Asia." *The New York Times*. July 6, 2019. <https://www.nytimes.com/2019/07/06/world/asia/china-russia-central-asia.html>

¹³⁴ John Hurley, Scott Morris, and Gailyn Portelance. "Examining Debt Implications of the Belt and Road Initiative from a Policy Perspective." *Center for Global Development*. March 2018. <https://www.cgdev.org/sites/default/files/examining-debt-implications-belt-and-road-initiative-policy-perspective.pdf>, pp. 19.

¹³⁵ Paul Globe. "China's Plan for Railway to Uzbekistan Is Transforming Central Asian Geopolitics." *The Jamestown Foundation*. March 21, 2019. <https://jamestown.org/program/chinas-plan-for-railway-to-uzbekistan-is-transforming-central-asian-geopolitics/>

¹³⁶ *Ibid.*, pp. 119.

¹³⁷ "Kyrgyz Republic Overview." *The World Bank*. Accessed July 10, 2019. <http://www.worldbank.org/en/country/kyrgyzrepublic/overview>.

¹³⁸ *Ibid.*

¹³⁹ Felicia Schwartz. "Retired CEO Held in Bulgaria, Faces Extradition to Kyrgyzstan." *The Wall Street Journal*. September 2, 2015. <https://www.wsj.com/articles/retired-ceo-held-in-bulgaria-faces-extradition-to-kyrgyzstan-1441212588>

step, these success stories serve as a reminder that adjusting the rule of law and regulatory frameworks – improving the soft infrastructure capacity of the country – are critical for the nation’s development.¹⁴⁰ Still, many burdensome regulations hinder business development for foreigners and locals alike.

Given its great need for updated infrastructure, the Kyrgyz government must focus on attracting FDI through regional partnerships and international development organizations while pivoting way from massive (and sometimes predatory) Chinese lenders. To achieve this, the Republic must demonstrated reduced risk in its high capital expenditure public private partnerships by promoting transparent business practices and demonstrating proper enforcement of contracts. Investment must also focus on sectors outside natural resources – the primary recipients of FDI – such as tourism, textiles and agriculture. Adjusting the laws and regulations to serve these sectors should be at the core of the country soft infrastructure development strategy.

Recommendations:

- **Embrace BRI:** Kyrgyzstan should continue to utilize BRI projects to increase the transit and investment potential of the country as it seeks to further integrate itself into the global marketplace. The government should, however, reduce its borrowing from China dramatically as 40% of the country’s \$8 billion external debt is already owed to China. Bishkek should attempt to secure lower interest loans from global financial institutions or pursue grants. In 2019 Kyrgyzstan applied for a \$56 million grant from China for a long delayed road project – this practice should be celebrated.¹⁴¹
- **Monetary Policy:** The Kyrgyz Republic must develop stronger fiscal regulations and oversight, as foreign loans have suffered significant corruption under government officials, estimated by the United Nations Development Programme to have cost the government \$700 million as of 2014.¹⁴² Ideally, rather than relying on the Export-Import Bank of China to distribute funds, Kyrgyzstan must either create a financial regulatory body of its own to ensure project integrity and feasibility, or pass off that responsibility to an intermediary – such as the Asian Development Bank (ADB), which has funded dozens of economic development projects in the country already.
- **Tax and Customs Policy:** To reduce import and export barriers, Kyrgyzstan needs to introduce modern methods of tax administration based on new technologies (bar codes, QR encoding, RFID technologies, NFC tags, etc.). The government should also take measures aimed at equalizing the tax burden between large, medium and small businesses. They should strive to ensure that the SME grow to the point that the share of government revenues from small and medium-sized businesses is at least 50% of the budget’s tax revenues – thus reducing the outsized influence of a handful of monopolies and building a more stable tax base for future revenues.

¹⁴⁰ “The Law on Public-Private Partnerships in the Kyrgyz Republic.” *Public Private Partnership*. Accessed July 10, 2019. <https://ppp.worldbank.org/public-private-partnership/library/law-on-public-private-partnerships-kyrgyz-republic>.

¹⁴¹ “Kyrgyzstan Asks China for Grant Instead of Loan.” *Eurasianet*. February 28, 2019. <https://eurasianet.org/kyrgyzstan-asks-china-for-grant-instead-of-loan>

¹⁴² “Break the Corruption Chain Campaign Starts in Kyrgyzstan.” *United Nations Development Programme*. December 9, 2014. <http://www.kg.undp.org/content/kyrgyzstan/en/home/presscenter/pressreleases/2014/12/09/break-the-corruption-chain-starts-in-kyrgyzstan.html>

IV. Conclusion

Sustained development in Central Asia will require a renaissance of infrastructure development. This applies to both projects (hard infrastructure) and the “software” which facilitates the investment (“soft infrastructure”). Advancing proper, high capital expenditure infrastructure projects demands policymaker vision, access to capital, technical expertise, functioning markets, working dispute resolution mechanisms, including courts and arbitration, transparency within and outside the governments, and reliable government policies. Corruption, bureaucratic red tape, lack of transparency and property rights, and state-controlled markets remain the most significant barriers to development in the region.

But the arc of economic growth among the CARs is bending towards market liberalization and increased transparency. Led by Kazakhstan and, in the last three years, Uzbekistan, the CARs are making uneven progress in the soft infrastructure space to facilitate continued growth. Foreign direct investment and public-private partnerships are the keystones of large-scale development, and the region has largely succeeded in attracting partners for these projects, relative to the prior decade. The advent of the Belt and Road Initiative and concerted efforts by governments to pass business-friendly policies are major drivers of this growth.

Above all, investors, corporate, foreign state-backed, or multilateral, generally seek stable and lowest-risk environments with a certainty of economic return. That is why the political and financial reforms in Kazakhstan and Uzbekistan alongside strategic visions (Kazakhstan 2050), government commitments to promote innovation, economic diversification, and greater private sector competition promise that Kazakhstan will remain a regional leader in development in the short to medium term, followed by Uzbekistan. The United States, the EU, Japan and other OECD countries have a vested interest in Central Asia’s economic success.