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The project involves experts of research institutions and universities of Caucasus (Armenia, Azerbaijan and Georgia) and Central Asia (Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan and Kyrgyzstan) in preparing country analyses in specific group of topics: reform of the post-communist state (i.e. public administration reform, decentralization, anti-corruption, and human rights/access to justice); spatial poverty (i.e. interactions between geography, economic policies and activities, and living standards); economic, environmental and social impact of public economic policies (e.g. migration, employment, trade liberalization, inflation and administrative prices); rural development and agricultural reforms; financial access and microfinance.

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Implications and preventive measures of early fiscal expansion in Azerbaijan

Namig Tagiev and Rafiq Karimli

The main topic of the analysis is how fast increase in size of government has been causing inflation in Azerbaijan. Using oil revenues for big social programs that stimulates demand seems to be problematic as it gives continuous impulse to inflation. Mechanisms to reduce unemployment and poverty should be prepared for long run.

Controversies in the fiscal policy

One of the most important tools of government intervention into the economy is the fiscal policy. Fiscal policy is implemented on the basis of tax incomes, revenue and expenditure policy and is important part of financial policies. In order to implement its functions, government using its centralized funds redistributes part of national income after initial distribution process.

Increase in government intervention in some of the developed countries shows positive effects, while in others, causes unintended phenomena, like inflation, unemployment, social problems etc. From this point of view, increase in fiscal involvement of governments, especially in transition countries provokes controversies. Therefore, some experts try to find optimal level of fiscal expansion for their countries. This level is important for Azerbaijan also, but unfortunately it's difficult to measure it for our country in present situation.

Economics about the fiscal policy

As public relations develop, fiscal intervention deepens. Until nineteenth century government intervention into the social life of people was in narrow scope. But industrial revolution and accelerating urbanization has carried some social problems to public level. Solution of them made government intervention reasonable. In such a way, starting from the end of nineteenth century the size of government increased considerably.

At the same time, some economists thought that such extensive government intervention is unpleasant and rather questioned circumstance. But others, especially parallel to weakening classical theory considered this conversely. For instance, A. Wagner was considering social defense function of government at the same importance with other functions such as defense, legislation, authority. He thought that increase in size of government is valid as industrial development leads to it. In the first half of last century, due to gaps in "laissez faire" principles new theory occurred. This is known as the Keynesian theory. J. M. Keynes offered to cut tax rates and increase budget expenditures in order to encourage aggregate demand.

Milton Friedman had quite different approach, proposing to restrict government activity on market. He stated that "The major evil of paternalistic programs is their effect on the fabric of our society. They weaken the family; reduce the incentive to work, save and innovate; reduce the accumulation of capital; and limit our freedom. These are the fundamental standards by which they should be charged" (Friedman, Milton, and Friedman Rose, Free to Choose, London: Penguin 1980)

Transformation of fiscal policy

We can distinguish three types of countries from this point of view. First group of countries can be characterized by big size of government and low intervention. The second group can be typified by both sizable government and high level of intervention. The first group includes developed countries such as Western Europe countries. In these countries government is not interfering into market as competition is perfect compared to less developed countries. So, there is no need to interfere into the process so deeply. Second group of countries are those which gained minimum administrative expenditures and low intervention. Third group includes new transition countries and some developing countries. Unlike developed countries, optimal level of government intervention in these countries is difficult to measure.

Azerbaijan as per its present state belongs to the second group. After collapse of the Soviet Union, Azerbaijan decided to switch to market principles from planned, as other republics within the former SSSR. Economic relations with these countries suffered serious break in all terms. As a result, psychological adaptation into the new system of economic relations, and at the same time involuntary unemployment and poverty problems became actual issues.

While stagnation escalated throughout the country, implementation of new institutional and structural reforms due to transformation process became important and urgent. There was one deficiency for policymakers: the knowledge how to change western economic models into local condition. There were many proposals from local and international experts.

Starting from first half of nineties, structural unemployment was gradually surrounding all areas of the social life. On one hand hyperinflation, on the other hand long time delays in paying salaries of employees had brought social life to miserable condition.

The most important reforms that time were privatization, land reforms, reforms in banking system and others. Besides these reforms, government achieved signing of new projects on usage of countries energy resources with biggest transnational corporations and involving financial capital from different developed countries. Starting construction and installation works on these projects brought certain amount of foreign investment into the country and these caused recovery in oil and gas sector and other sectors relating to this, such as services, and construction.

On the basis of western experience, in order to avoid the phenomenon called "Dutch disease" and to save oil and gas revenues to future generation, government established State Oil Fund. This was met by foreign and local economists positively.

At the end of nineties there was slight but stable growth in the country. Increase in the size of government happened mainly from new entrepreneurship activities, increase in population income etc As economy stagnated, there were not so much businesses. But the number was rising considerably every year. And this of course increased potential taxpayers. It doesn't matter whether government increased or decreased tax rate. They were increasing because there was good condition for entrepreneurship activity. Together with revenues, budget expenditures also were going up mainly to social protection, education, and healthcare. Economic growth rate and increase in the size of government did not lead to inflation. In contrast, in 1999 CPI was minus 8.5% (deflation) compared to same period of previous year. Someone can think that deflation is same problem as inflation, but in this case, from the viewpoint of welfare of population this was met positively.

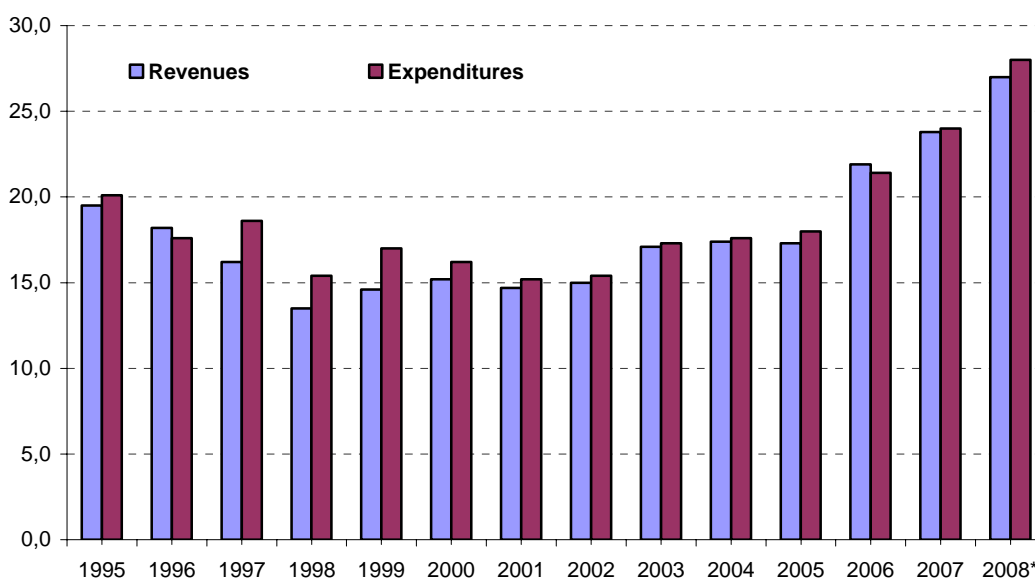
Government economic policy in this sphere was corresponding to neo-Keynesian theory. It stated that use of Oil Fund's revenues to non-oil sector would lead to economic growth by stimulation of aggregate demand, would decrease number of unemployed, and also reduce poverty level through social programs.

So, starting from 2004, part of construction works on Production Sharing Agreement (PSA) operated by BP finished. We started to export crude oil through Baku-Tbilisi-Ceyhan oil-pipeline and income of the Oil Fund raised. So, government started implement its big social programs using these funds. Azerbaijan International Operation Company (AIOC) started to receive profits from export of oil from its share and paid tax from its profit. All this funds and payments were accomplished in dollars, this increased flow of foreign currency into the country through increase of taxes and transfers from State Oil Fund into the budget. This caused fast growth in real GDP – the highest in last decade. For 2004 this indicator was only 7%, but because of the mentioned reason this figure became 26.4% and 34.5% in 2006 respectively.

This boom caused economic recovery and fast growth of population's income. Besides these, balance of payment also became positive in last few years, deposits of population in banks have risen year by year. Starting from 2003 the number of newly created work places also has expanded. The poverty level has decreased in the last 6 years from 49% to about 21%.

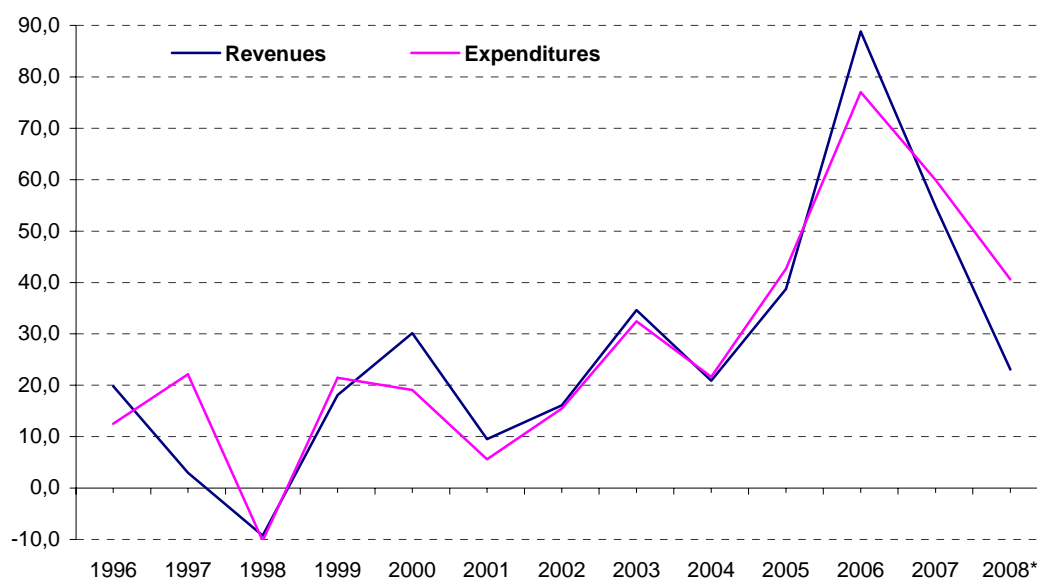
Economic growth considerably influenced revenues of state budget. However, these revenues were not enough to finance the government's big social programs. So, there was a need for involving additional resources. State Oil Fund revenues were available and government decided to use it despite criticism by foreign and local experts. As a result budget deficit also were financed every year by previously separated funds.

Chart 1. Budget revenues and expenditures in Azerbaijan, 1995-2008 (% of GDP)



* Forecast, Source: State Statistical Committee of Azerbaijan

Chart 2 shows that starting from 2004 budget revenues increased 20% compared to 2003. In 2005 this figure was 38% and in 2006 it was 88%. At the same time, if until 1998 the size of government was decreasing, starting from 1999 it was rising significantly. Some experts do not consider usage of State Oil Fund revenues in the near perspective at all, while others propose to use it only to industrial and processing sector rather than social programs and building.

Chart 2. Annual growth of budget revenues and expenditures in Azerbaijan, 1996-2008 (%)

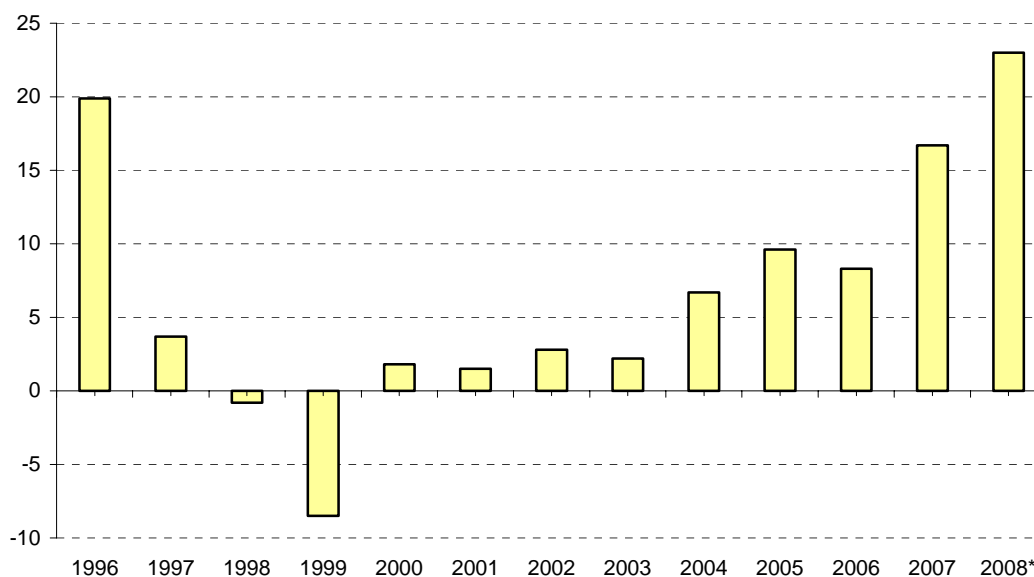
* Forecast, Source: State Statistical Committee of Azerbaijan

Inflationary pressures correlated with fiscal policy

Along with all these problems, due transfers of oil revenues to state budget, increase in tax payments of State Oil Company (SOCAR) and AIOC increased pressure of foreign currency into the local currency market as these payments implemented in dollars. As a result, demand for national currency, Azerbaijani manat (AZN) increased and its exchange rate appreciated compared to dollar and other currencies. On the other hand, in order to keep AZN exchange rate stable these dollars were sterilized by the National Bank of Azerbaijan. This led to rise of money emission and increased M2 aggregate in turnover, causing inflation above the specified target.

Thus, just until 2004 – oil boom years – inflation level was stable and even minus. But after this year as we can see on *Chart 3* firstly in the course of last seven years became 6.7%. For the end of 2007 compared to the same period of 2006 increase of CPI was 16.7% and these became very problematic either for households, for business and for government. The forecast by the Statistical Committee of Azerbaijan Republic for inflation for the end of 2008 is about 23%, which is very high if comparing with other countries of the Commonwealth of Independent States (CIS). Of course, increase of international food prices is also reason for inflation but as per the National Bank of Azerbaijan this inflation is only 7% of overall price increase.

Increase in inflation level is interpreted differently by various experts from inside and outside the country. Thus, one group of economists relates this problem with the increase of commodities prices in the world. Another group of specialists interpret it as a result of increase of energy prices by government (petroleum, diesel and gas for public use), monetary factors, and economic growth. Energy prices have been raised by government and a reason was the pressure from international organizations. But, one thing we have always to keep in mind: these prices should be raised only parallel to income of population. If the minimum level of salary in this country is six or seven times less than a given country, how can we increase petroleum, diesel and gas prices up to those countries level?

Chart 3. Annual average CPI growth in Azerbaijan 1996-2008 (%)

* Forecast, Source: National bank of the Azerbaijan Republic

Actually, all of above mentioned are the reasons of inflation at the moment. Thus, all these factors are appearances of demand, supply and import inflation. But, if we can see the problem from more general aspect, we can find out that the main problem of the inflation is abnormal increase of the size of the government. Thus, as we see from above graphs increase in inflation rate in the country started from 2004 in which budget revenues and expenditures also increased. It comes out then that, magnitude social projects which are implemented by government from budget and oil revenues to reduce poverty level has given impetus to high speed increase of inflation.

Consequences and recommendations

To solve the aforementioned challenges the government should implement measures. The government has to use of State Oil Fund revenues to lesser extent financing income and social policies of the budget. Budget expenditures to building sphere should be directed to heavy industry spheres and to agricultural processing sector, especially to products with comparative advantages. As we know private sector is very flexible. Business people are smart and are interested to get easy money like in building, construction, services etc. than to do heavy works and gain less income. We have some spheres in agricultural processing and food industry which requires huge investment. These sectors unlike building and construction are permanent and labor-intensive. We have experience in some spheres of heavy industry like oil machinery, steel production and so on, compared to other countries. Serious anti-monopoly measures have to be implemented in order to prevent inflation and to decrease its level. In some areas of economy we have monopolies, which dictate on prices. This problem also should be solved by government measures. Decrease of tax rates and a complete tax reform is desirable in order to develop real sector by stimulating aggregate supply.

Governmental structural reform to fight corruption and economic crime in Georgia

Shalva Machavariani

Main goal of this analysis is to reveal the objective reasons of corruption and economic crime in Georgia before the “Rose Revolution” and the situation after the revolution, and to examine the relationship between structural reform and the level of corruption and economic crime. The creation of an efficient public administration system together with the establishment of governmental institutions meeting modern requirements, is regarded a necessary prerequisite for overcoming corruption and economic crime.

History and data

Public administration system of Georgia before 2004 was characterized by an inefficient policymaking and policy implementation, especially in the social sector¹ and high levels of corruption and economic crime. In October 2003 the report of Transparency International (an international organization tackling corruption) exhibited that Georgia had ranked 127th in its Corruption Perception Index report;² whereas in the 2000 data of the same organization Georgia shared 84-86th places with Albania and Kazakhstan.³

The level of shadow economy was rather high; at the beginning of 2002 in some sectors of the economy it reached 60% of GDP.⁴

From the point of view of businessmen the main factors to hinder business development in 2000, 2001 and 2002 were: corruption of civil servants (62.7%, 52.6% and 63.6% of businessman respondents respectively), too much negative influence of civil servants into business (50.6%, 59.5% and 61.9% of businessman respondents respectively).⁵

Corruption of public officials and “protectionism” of business they provided resulted in 13.7% share of tax revenues in GDP 2002 - this was the lowest figure registered in all post-soviet countries.⁶

Before 2003 the following factors characterized Georgia: inflated and poorly coordinated system of the central government structure; high rate of functions duplication in different governmental organizations, absence of openness and transparency of government activities; insufficient involvement of the civil society in policymaking resulting in the estrangement of considerable part of population from the governmental structures and the lack of trust in legality of their activities, inefficiency of law enforcement mechanisms vs. rapid changes in legislation, an inefficient system of power distribution between the center and the regions, low indicators of decentralization, insufficiently accomplished local budgets, lack of political consensus at central, regional and local governmental levels, misbalanced and discrete administrative system – everything resulted from the existing system.

1 The World Bank Georgia, Civil Service Assessment. Status, Issues, Strategy. 1998, p.69

2 Transparency International Annual Report 2003

3 Transparency International Annual Report 2000

4 Hiding in the Shadows The Growth of Underground Economy, publication 30, International Monetary Fund, 2002, April

5 Entrepreneurship in Georgia. State Department of Statistics of Georgia. Statistical Publication, Tbilisi, 2000, p. 28-30 and Entrepreneurship in Georgia. State Department of Statistics of Georgia. Statistical Publication, Tbilisi, 2001, p. 102 – 105

6 Georgian Economic Trends. Georgian – European Policy and Legal Advice Centre. Quarterly Review, 2002, 1, p. 9 – 10

The system was created for serving a different regime with different social and economic preferences. It opposed to basic principles of market economy; failed to support proper development of private property and to stimulate equal participation of all members of society in current economic processes.

It is acknowledged that corruption, inefficient governmental structures and economic problems are entirely interrelated phenomena that nurture each other.⁷ Therefore, the creation of an efficient public administration system together with the establishment of governmental institutions meeting modern requirements is a necessary prerequisite for overcoming corruption and economic crime.

Table 1. Statistical data on civil servants at governmental institutions (31 December 2002 – 31 December 2003)

<i>Indicator</i>	Ministries	State departments	State inspections	Other institutions	Total
Number of civil servants on the staff list	51 451	10 703	113	11 163	73 203
Number of civil servants on the list at the end of the accounting period	47 009	8 223	112	10 989	66 333
Number of public officials	44 756	4 303	102	8 025	57 186

Before 2004 Georgia had rather large and rigid administrative system. Executive power only included 18 ministries, State Chancery, 18 state departments, 3 governmental inspections and services, 10 sub-departmental institutions under the jurisdiction of the State Chancery, 93 sub-departmental institutions under the jurisdiction of ministries, 9 republican departments, 75 juridical entities of public law and 3 regulatory commissions, territorial units.⁸ For the period of 31 December 2002 - 66333 civil servants (Table 1) were registered at governmental institutions.⁹

Analysis of potential to coordinate administrative system of the executive power

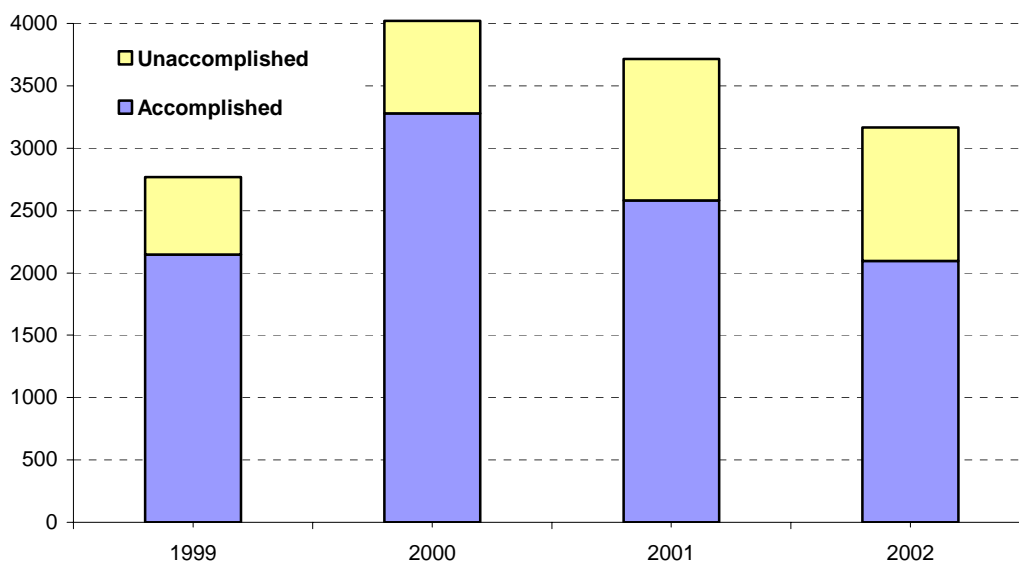
The analysis of implementation of tasks assigned to ministries, departments and governmental commissions has revealed problems in accomplishment of obligations and a tendency of worsening was observed. Percentage of accomplished obligations in 1999 (77.8%) was significantly improved in 2000 and constituted 81.6%. This was followed by significant decline (69.5%) in 2001 and 66.2% in 2002 (*Chart 4*).

7 Daniel Kaufmann. *New Empirical Frontiers in Fighting Corruption and Improving Governance – a few selected issues*. Background Comments and Empirics for OSCE Economic Forum 2001, January 30-31. www.worldbank.org/wbi/governance

8 Shalva Machavariani, Lali Gigashvili. *How Weaknesses in Georgia's System of Public Administration Foster Corruption*. Conference "Economic Crime & Money Laundering in Georgia." Transnational Crime & Corruption Center. Georgian Money Laundering Project. Tbilisi, 2004, June 29- 30, p. 40-74

9 Law of Georgia "On Structure and Operation Rules of the Executive Power." Tbilisi, 1997

Chart 4. Dynamics of change: number of tasks assigned in governmental organizations for the period of 1999-2002



Source: own resources

Situation was different in terms of frequency of assigned tasks. In 1999 and 2000 State Chancery assigned 12 daily tasks on average, whereas in 2001 their number was reduced to 10.5 and increased considerably to 19.5 in the first 6 months of 2003. The increased frequency of assigned tasks in the first half of 2003 together with the lowest percentage of accomplishment of timed tasks and the dramatic increase in number of delayed jobs provides ground for the following assumption that the existing administrative system has exhausted its capabilities and paralysis was expected unless steps were undertaken to implement immediate structural reforms. Despite the fact that the State Chancery coordinated activities of governmental structures better than ever (e.g. accomplishment of tasks assigned to governmental commissions reached the highest rate - 84.5%), it was impossible to achieve better results within this system. Too much tasks assigned to ministries gives an impression that they can not function properly without the tight supervision of the State Chancellery. That demonstrated autocratic style of administration in the country. During many years the Ministry of Finance has been a leader in terms of assigned tasks – in the first half of 2003 on average 2-3 daily tasks were assigned to it. Accordingly, the share of unmet obligations was traditionally high.¹⁰

Apart from the aforementioned studies, the Chamber of Control of Georgia have revealed types of violations characteristic for governmental organizations, in particular failure to fulfill rights and duties conferred by law, exceeding the rights conferred by law, misuse of budgetary resources, violations in the process of receiving and utilization of non-budgetary revenues (special resources), inadequacies existent in utilization and distribution of the state property.¹¹

10 Shalva Machavariani. The Main Weaknesses of the Management System in the State Administration of Georgia as Supporting Factors for Corruption and money Laundering. Selected papers presented at the Annual Conference of the European Society of Criminology, Helsinki 2003. European Institute for Crime Prevention and Control, affiliated to the United Nations. Publication Series 42, Helsinki, 2004, p.147-156 and Shalva Machavariani, Overcoming Economic Crime in Georgia Through Public Service Reform, in "Organized Crime and Corruption in Georgia" edited by Louise Shelley, Erik Scott and Anthony Latta, Rotledge, London and New York, 2007, 37- 49

11 Shalva Machavariani. Some Issues Concerning Formation of the Executive Structures. Caucasus School of Business, The first Scientific Conference: Economic Crime as the Major Interfering Factor for Economic Development of the Country. Tbilisi 2003, 7-10

The largest part of budgetary governmental expenditure was public administration costs that constituted 25.2% of total governmental costs.¹² At that period a number of governmental institutions were reduced dramatically; this was implemented in the framework of the newly adopted law: “On the Authority and Operation Rules of Governmental Structure”. Based on this law, in November 2004, the overall 18 ministries and 18 state departments were reduced to 13 ministries. Implemented structural changes made it possible to save significant budgetary resources, thus, providing the basis for increasing salary rates of civil servants.

Positive changes are noticeable in the administrative system of Georgia thanks to the recent efforts of the government; at the beginning of 2005 a lot was done for its reduction, international organization and World Bank report. Since the end of 2004 the new government’s effects have significantly improved fiscal administration, scaled back Georgia’s shadow economy, and produced a significant decrease in corruption in the public and private sectors as measured by international standards: The World Bank hails Georgian as the top anticorruption performer in its 2006 Anticorruption in Transition – 3 (ACT3) report.

But in order to operate effective administration responding to modern requirements it is necessary to continue initiated reform in an orderly manner. At this transitional stage qualitative changes should be introduced to the structural units formed by mechanical combination of existing ministries, state departments and other institutions in order to successfully overcome “administrative remnants” of the old system that are still obvious today.

Recommendations, further steps

Some suggestions and principles are proposed combating corruption and economic crime originated from specialties of public administration system. For the improved qualitative coordination of executive power institutions it is necessary to develop unified action plan – reform and development strategy for the system of governmental institutions. Executive power institutions should be structured in accordance with the development strategy. This approach could, on the one hand, orient these institutions at the solution of existing problems, and on the other hand, balance their activities excluding functional duplication and parallelism.

Formation of executive power structures should necessarily take into consideration the EU requirements on effectiveness, transparency and economy of these structures. Executive power organizations of departmental level should be implementing only conceptual activities related to policy implementation, forecasting, planning and monitoring etc. They should be deprived of all economic functions and all these functions should be transferred to secondary level organizations (regulatory commissions). Strict definition of activities of executive sub-departmental organizations (tertiary level institutions) is necessary. Their necessity should be based on the principle: to what extent (how effectively) they support activities of higher level governmental organizations.

In order to implement modern approaches of administration in executive power institutions it is necessary to delegate duties and responsibilities to as lower level as possible, to develop job descriptions and position requirements in accordance with new organizational technologies. This requires the introduction of new role-based organizational culture.

Human resource management in executive power institutions need to be improved to meet modern requirements of appointment on a new position. Ongoing attestation and promotions should be performed

12 Official data of the Ministry of Finance of Georgia: www.mof.ge

only in line with job description and position requirements. Staff training and retraining should be performed in accordance with position requirements. Objective criteria need to be developed for performance evaluation and motivation of civil servants, database of civil servants and dormant labor reserves need to be developed. Work of HR managers of governmental organizations should undergo qualitative changes. Effective incentives system should be developed for public service sector efficiently involving both (material and moral) components of motivation.

In order to overcome financial and economic violations taking place in executive power institutions it is necessary to change the budgeting principle of the State Budget from the functional to the programmatic one. In order to use unified approach during the executive power reform it is necessary to award appropriate functions to the Civil Service Bureau. For the efficient functioning of the public service the improvement of the legislative base is crucial; this is primarily related to the correspondence of sub-legislative acts with each other and current processes.

Foreign trade and its social implications in Uzbekistan

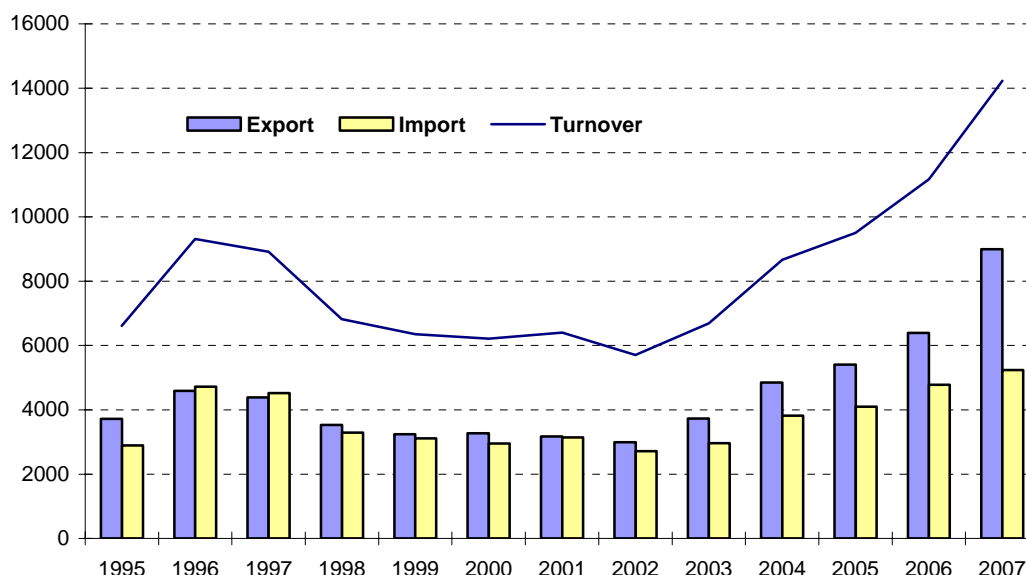
Gulnoz R. Bikbaeva¹³

Economic reforms aimed at establishing an open market economy, played a definite role in creating vast opportunities for active participation of Uzbekistan in international trade. The main goal was the maximum utilization of the benefits of international division of labor and globalization processes. This has resulted in high growth rates of foreign trade in recent years.

Past developments and main drivers

There were periods of growth and decline in the development of foreign trade of Uzbekistan over the past 13 years. The reason for these fluctuations can be attributed to two main factors: world prices of the main export commodities of Uzbekistan and consistent measures to promote foreign trade by the State.

Chart 5. The dynamics of foreign trade in Uzbekistan, 1995-2007 (USD thousand)



Source: State Committee on Statistics of Uzbekistan

The influence of world prices: Uzbekistan produces and exports gold, cotton fiber, machinery and equipment, chemical products and plastics and some other goods. Periods of export growth were observed in 1995-1997, and starting from 2003. In the 1995-1996 period, average export prices of cotton fiber were 11-13% higher compared to 1994, while prices of cotton fabrics were 50-140%, and those of nitrogen fertilizers 25-110% higher respectively. So, one of the reasons behind export growth was the significant rise of world prices for goods which were exported by Uzbekistan.

However, in the period 1997-2002 (with the exception of 2001), there was a decline in both export and import values. In 2002, foreign trade turnover in value terms was lower than in 1996 by not less than 39%, (exports by 34.9% and imports by 42.6%). One of the main factors that led to the reduction of the value of exports

¹³ researcher, Banking and Finance Academy of Uzbekistan

during the period under review was declining world prices for the main export commodities of Uzbekistan. In this time interval the world prices for cotton fiber decreased by more than two times compared to 1995 levels. Other prices also significantly decreased: the price of gold went down by nearly 30% during 1996-2001 and that of copper by 45% during 1995-2002 in the world markets.

Following a relatively stable four year period, foreign trade again began to increase from 2003 that still lasts now. In particular, in 2003, Uzbekistan's foreign trade turnover increased by 17.3% compared to 2002, including a rise of exports at a rate of 24.6%. A trend growth in the world price for gold started in 2002: it increased by 30% in the first year and by a further 35% in 2003. 2003 was also a year of increasing cotton fiber prices. This was due to factors such as growing external demand, decline in the expected harvest in China, the low yield of cotton in the main exporter of it - the US, as well as speculation on the cotton exchange.

Foreign trade policy: The Government of Uzbekistan runs an economic policy aimed at restructuring the economy. The main purpose of this policy is the integration of Uzbekistan into the world economy as a fully coequal participant in world economic relations with the dominant share of manufactured export characterized by higher value added goods and services. Therefore, the spectacular export growth of Uzbekistan is not only because of the improving global environment for the traditional export commodities of the country, but is also because of an appropriate policy mix. Within it an important role was given to the devaluation of the Uzbek national currency (soum or UZS) against USD, which led to better price competitiveness of domestic producers. The unification of exchange rates and the introduction of the convertibility of the national currency on current transactions were also important parts of these policies.

In addition to these factors, the export of non-oil goods such as cars, petrochemical products, metal products, chemical fertilizers, cotton yarn and fabrics, knitted products, cables and conductors, building materials and much more have increased at outstanding rates since 2003. Additionally, the structure of foreign trade by geographical areas has also changed. In all, foreign trade turnover doubled between 2003 and 2007 and amounted to USD 14227.1 billion in the latter year. Of this, 63.2% represents export and 36.8% import operations.

Geographical structure of foreign trade

Due to the domination of commodity goods in the structure of its foreign trade, Uzbekistan seeks reliable partners among non-CIS countries (*Table 2*).

Table 2. The geographic structure of Uzbekistan's foreign trade, 2000-2007 (%)

	2000	2001	2002	2003	2004	2005	2006	2007
Turnover	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
CIS countries	37.0	35.7	32.0	31.5	34.6	35.8	42.5	49.2
Non-CIS countries	63.0	64.3	68.0	68.5	65.4	64.2	57.5	50.8
Export	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
CIS countries	35.9	34.2	27.6	26.0	31.5	31.8	42.0	47.5
Non-CIS countries	64.1	65.8	72.4	74.0	68.5	68.2	58.0	52.5
Import	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
CIS countries	38.2	37.2	36.9	38.3	38.6	41.1	43.1	52.0
Non-CIS countries	61.8	62.8	63.1	61.7	61.4	58.9	56.9	48.0

Source: State Committee on Statistics of Uzbekistan

The need to import advanced equipment and technology produced mainly in the developed market economies, , as well as a policy of diversification of import and an introduction of market principles in the import policy, helped to raise the proportion of foreign countries and also the import volume of the country.

But it is obvious that in the last four years the share of CIS countries in foreign trade was gradually increasing both in exports and imports. Comparing the dynamics of exports and imports to/from the CIS countries it may be noted that export figures raised especially sharply in 2006 and this also continued in 2007. One of the main reasons of this increase is that the three largest importer of Uzbek goods in 2006 (Russia, Ukraine and Kazakhstan) all faced rapid economic growth with an investment boom, thus their demand for Uzbek export products markedly strengthened.

The analysis of geographical directions of export shows that the CIS countries accounted for 47.5% of the volume of exports in 2007. Among the CIS countries the major trading partners of Uzbekistan are Russia, Kazakhstan, Ukraine and Tajikistan. Besides raw materials and agriculture products, the most significant export goods delivered to these countries are energy, plastics and products thereof, automobiles, aircraft, farm equipment, electrical machinery and equipment, cables and conductor technology. There is also a significant amount of export commodities that are fulfilling mass demand abroad, including fresh and processed fruits, vegetables, nuts and other foodstuffs, textile products and knitted clothing, and various other durable goods.

However, significant transport costs due to relatively high tariffs for rail freight, as well as the need to transit through third countries serves as a severe factor reducing the potential competitive advantage of Uzbek export products in their delivery to the markets of Russia, Ukraine, Azerbaijan and Belarus.

Table 3. The geographic structure of Uzbekistan's foreign trade (share in total volume, %)

Country	Export		Import	
	2004	2006	2004	2006
CIS countries	31.5	42.0	38.6	44.8
Russia	14.9	26	24.0	26.5
Kazakhstan	3.8	4.8	6.3	9.4
Tajikistan	3.0	2.7	1.0	0.4
Ukraine	2.3	5.7	4.5	5.8
Others	7.5	2.9	2.8	2.7
Group of non-CIS countries	68.5	58.0	61.4	55.2
Great Britain	7.9	2.9	1.8	1.6
Germany	1.0	1.2	7.1	5.6
India	2.5	0.2	0.7	1.1
Iran	6.9	9.7	0.9	0.9
South Korea	1.2	0.7	9.2	12.9
USA	3.1	1.9	10.3	2.9
Turkey	4.5	9.0	4.5	3.4
France	0.7	1.4	1.2	1.0
Switzerland	3.1	0.5	0.4	0.8
Japan	0.4	0.4	2.1	1.0
Others	37.2	30.1	14.9	24.0
TOTAL	100.0	100.0	100.0	100.0

Source: State Committee on Statistics of Uzbekistan

Among the non-CIS countries Uzbekistan mainly exports to the markets of the European Union, Southeast Asia and the Near- and Middle East. These markets are all characterized by high demand, but the countries of the region themselves have developed production system of various goods and services, and in many cases are the leading producers of high-tech equipments and goods of mass demand. Strong demand for high quality goods makes pricing a very important factor for success. Yet, the share of manufactured exports is still small. In large part, this is fresh and processed fruits and vegetables, chemical products and plastics in primary forms.

The main types of export goods to the Southeast Asian countries are commodities and raw materials. Compared to Europe and the US, the structure of exports is more diverse in the Eastern relation. It consists of cotton fiber, silk, yarn, fabric and other textile products, technical oils, chemical threads and fiber, some types of machinery and equipment.

Besides raw and semi-finished materials finished goods are also exported to the countries in the Near and Middle East (Iran, Israel, Turkey, Afghanistan, United Arab Emirates, Saudi Arabia, Egypt). These include fiber cotton, yarn and fabrics, other textile products, ferrous and non-ferrous metals (copper, zinc and articles thereof), food products including cereals, building materials, cement, mineral and chemical products including chemical fertilizers, chemical fiber, refined petroleum products and gas. There are also good prospects for Uzbekistan's export products in Afghanistan's markets. However, exporting to this market is constrained by a number of factors, including the lack of effective transportation links and the lack of a relatively developed banking system.

The commodity structure of foreign trade

The comparative analysis of the five major export articles between 1995 and 2007 clearly exhibits some changes. Food is no longer among the top five export articles, while cars assembled in Uzbekistan are among the major export products now. Export is more diversified, which is reflected by the fact that the share of the five largest export goods dropped from 77.2% to 65.3%. As it is shown in *Table 4*, the structure of exports is still dominated by primary commodities.

Table 4. The structure of major export commodities in Uzbekistan

1995		2007	
Name of the product	Share in total exports	Name of the product	Share in total exports
Cotton-fiber	48.4	Energy resources	20.2
Energy resources	11.7	Cotton-fiber	12.5
Services	7.7	Ferrous and non-ferrous metals	11.5
Food products	4.7	Services	10.7
Ferrous and non-ferrous metals	4.7	Machinery and equipment	10.4
Chemical products and plastics	2.5	Food products	8.5
Machinery and equipment	2.0	Chemical products and plastics	6.8
Others	18.3	Others	19.4
Total	100.0	Total	100.0

Source: State Committee on Statistics of Uzbekistan

As it is shown above, in 2007 the share of primary commodities in total exports amounted to 44.2%. Compared to 1995, when the share of primary commodities in the country's total exports was 64.8%, this represents a marked fall. Over the past 13 years, merchandise exports, also including non-oil products grew from 9.2% to 36.4%.

Thus, we can make the following conclusions: first, the share of commodities in the total value of exports fell by 20.6% (mainly by a significant reduction in the share of cotton fiber), even despite the growth in world commodity prices; secondly, the increased share of services in export shows an increase in labor migration abroad; thirdly, the increasing share of "Machinery and equipment", which predominantly covers car production in Uzbekistan, reflects its strong competitiveness in the external markets (cars are mostly exported to Russia).

According to some Uzbek and foreign economists, the key to increase the proportion of non-oil exports is an economic policy focusing on foreign trade development through attracting foreign direct investment. It is generally acknowledged that Uzbekistan has many advantages, among others rich reserves of minerals, natural and climatic conditions that are favorable for the cultivation of many crops, but also to save energy, world-famous rich cultural and historical heritage, which offers ample benefits for developing tourism and related businesses, relatively cheap, but skilled labor force, significant scientific potential and an improving infrastructure.

Comparing the structure of the five major imported goods in 1995 and 2007, we may note that the composition of goods has not yet been as immense as in the case of exports. Some goods changed their ranks among the five leading articles, but shares have not changed so dramatically. The most significant decline is in the share of food that decreased to 7.9% from 17.7%. It reflects that local producers can now satisfy domestic demand for food to a larger extent. In all, the proportion of the most important import commodities has declined from 97% to 88.3%, also implying some diversification.

Table 5. The structure of imports of Uzbekistan, 1995 and 2007

1995		2007	
Name of the product	Share in total imports (%)	Name of the product	Share in total imports (%)
Machinery and equipment	57.3	Machinery and equipment	46.6
Food products	17.7	Chemical products and plastics	14.8
Chemical products and plastics	9.4	Ferrous and non-ferrous metals	8.3
Ferrous and non-ferrous metals	5.7	Food products	7.9
Services	5.0	Services	7.4
Energy resources	1.9	Energy resources	3.3
Others	3.0	Others	11.7
TOTAL	100.0	TOTAL	100.0

Source: State Committee on Statistics of Uzbekistan

In the commodity structure of import commodity groups such as machinery and equipment, chemical products, ferrous and non-ferrous metals continue to retain the leading places. Demand is especially strong for those imported goods that are needed to the reproduction cycle of enterprises, i.e. the implementation of investment projects.

Consequences, outlook and needed steps

Further developments concerning Uzbekistan's integration into the global economy are closely linked to the deepening of economic reforms and the restructuring of the economy. It is widely accepted that foreign trade largely contributes to welfare and human well-being. The theoretical literature in this respect describes the benefits of trade to economic growth and human development. Therefore, intensifying foreign trade can improve the country's economy by enlarging markets for goods and services. By doing so it also enhances people's choices. Increased employment provides a boost for household income, which - depending on how it is spent - can broaden human capabilities. Furthermore, economic growth can influence welfare and human development through government policies and spending. Economic growth increases government revenue, and as long as this revenue is used for the purposes of reducing income inequalities, health or education, human development will always benefit.

It is worth mentioning that the integration into world markets creates not only opportunities, but also risks, which can impose high costs on human development. Poorer countries that depend on the export of only one or two commodities may face high market risks. These risks are linked to price fluctuations and the potential for policy changes in the importing countries. Exporters of some manufactured goods also face straight vulnerability due to their exposure to negative shocks originating from abroad. Moreover, the effects of imports from developing countries on wages and employment in rich countries are often exaggerated. Inappropriately regulated export growth can also undermine human development through its impact on the environment.

Therefore, "in order to maximize the welfare gains from trade, and to strengthen the political case for participation in trade, it is important that the winners compensate the losers. That compensation can take various forms of transfers between countries and public policies within countries to create the conditions under which losers are protected and provided with opportunities".¹⁴

14 Human Development Report (2005): International cooperation at a crossroads: Aid, trade and security in an unequal world
http://hdr.undp.org/en/media/HDR05_complete.pdf

Energy efficiency and sustainability of energy policies in the CCA countries

Tamás Borkó

As countries of high energy intensity, CCA economies have to face challenges concerning the sustainability of their energy policies. This has implications not only for the phenomena of effectiveness, but also for the social, environmental and technological issues.

Climate change and its consequences

Climate change is one of the key challenges of mankind in the 21st century. Best available estimates of the 4th Assessment Report of the Intergovernmental Panel on Climate Change¹⁵ suggest that global warming from 1990 levels until 2100 will range between 1.8°C to 4°C.

Temperature changes on such magnitude have far-reaching economic consequences. Various economic sectors depend on climatic conditions and are therefore directly impacted. These economic sectors especially include agriculture, forestry, fisheries, tourism and health. But also infrastructure, energy, transport and financial/insurance sectors will be impacted.

Estimates for the costs of climate change are wide-ranging. Mean estimates from benchmark integrated assessment models point to losses between 0 and 3% of global GDP (see Stern, 2007¹⁶ or IMF, 2008¹⁷ for a review). Global catastrophes (with low probability but very high impact), extreme weather and socially contingent events and other non-market costs may easily push the total cost of climate change significantly higher, especially in countries of special character.

Responsibility and sustainable energy policy

As all economies of the world, the countries of Caucasus and Central Asia (CCA) also have to contribute to the common objectives regarding climate change and their extremely serious consequences. Appropriate policy responses are necessary to mitigate these impacts as spontaneous mitigation of and adaptation to climate change is viewed as inadequate. Planned adaptation measures involve public actors and result from deliberate policy-decisions. Planned adaptation can be either reactive (response to actual climate impacts) or anticipatory (undertaken before climate impacts are felt).

Energy efficiency is a key factor from this point of view. Countries rich in energy resources are less urged to take measures to make energy use more efficient. They can also afford to subsidize domestic energy consumption by using non-market prices for local consumers. However, they have to recognize that the changing energy market conditions (demand, prices, and supplies) could make their own local energy

15 Alcamo, J., J. M. Moreno, B. Nováky, M. Bindi, R. J. N. Devoy, C. Giannakopoulos, E. Martin, J. E. Olesen and A. Shvidenko (2007): "Europe". In: M. L. Parry, O. F. Canziani, J. P. Palutikof, P. J. van der Linden and C. E. Hanson (eds.): *Climate Change 2007: Impacts, Adaptation and Vulnerability*. Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, UK, pp. 541-580.

16 Stern, N. (2007): *The Economics of Climate Change*. The Stern Review, Cambridge University Press.

17 IMF (2008): "Climate Change and the Global Economy". In: *World Economic Outlook, April 2008*, International Monetary Fund, Washington D.C.

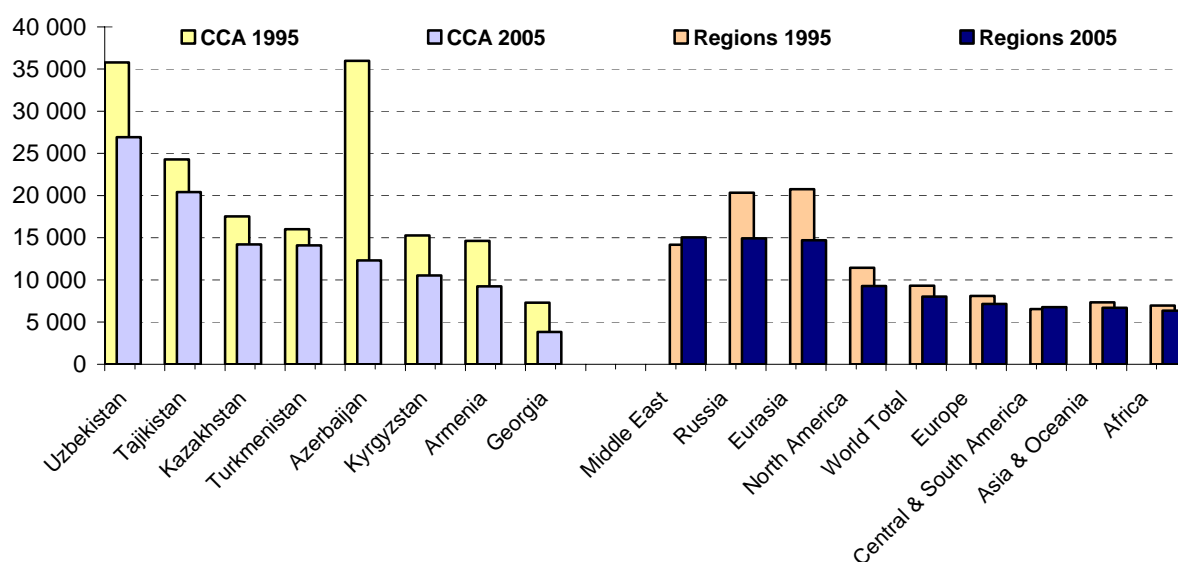
markets more vulnerable. Furthermore, the opportunity cost of non-market energy prices is significant. Energy efficiency would reduce domestic consumption (and the cost of subsidies), improve related technologies and infrastructures, and leave more resources available for exports. Energy-poor countries have even more at stake to decrease their political and economic vulnerability.

The other key factor is renewable energy that has to be developed in order to have environmentally, socially and on the long run economically sustainable energy policies. Sooner or later, energy-rich countries will have to deal with depletion of their reserves. A well-diversified energy profile can mean proper solution to future challenges.

Energy efficiency in CCA countries

Energy intensity is calculated as units of energy per unit of GDP. It is a measure of the energy efficiency of a nation's economy.¹⁸ Productivity of the economy, climatic and weather conditions, demographic and travel patterns, the energy efficiency of consumer goods and buildings are the main determinants of energy intensity.

Chart 6. Energy Intensity in CCA countries and regions of the world, 1995 and 2005¹⁹
(Btu per USD at 2000)



Source: Energy Information Administration

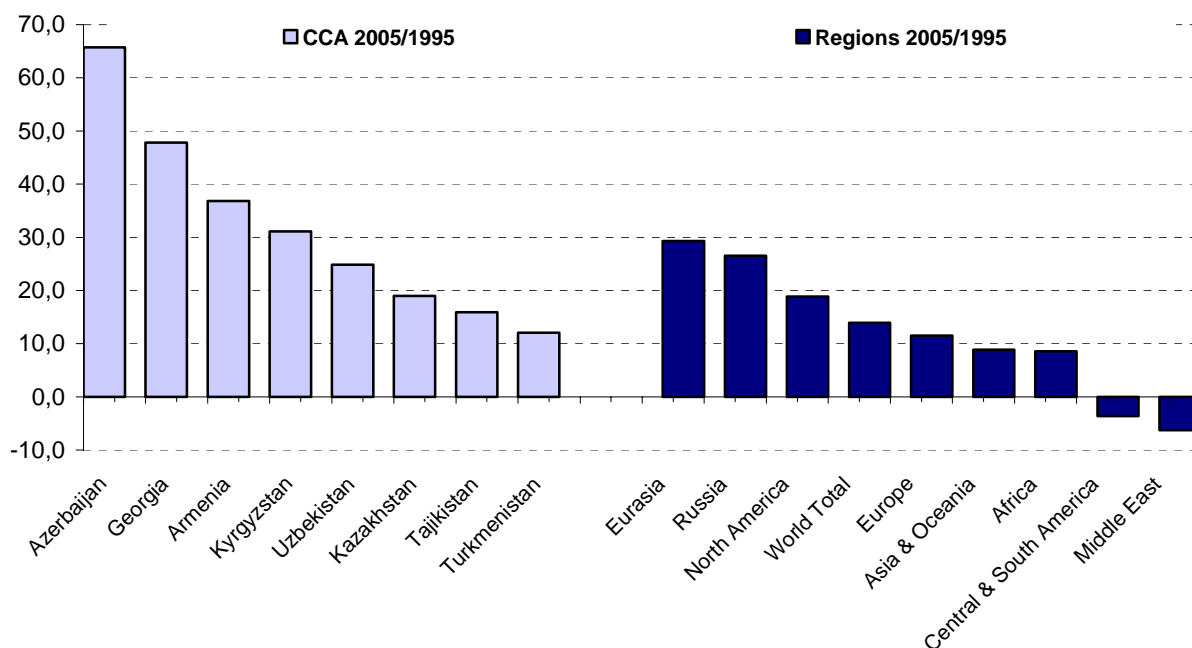
According to the latest (2005) comparable data from the *Energy Information Administration (EIA)*, the energy intensity (*Chart 6*) of CCA countries in general is among the highest in the world, which means that the cost of converting energy into GDP is relatively high. Obviously, CCA countries show a diverse picture. Countries of Central Asia are less energy efficient than their Caucasian counterparts. The only exception is Azerbaijan that is resource-rich as most Central Asian economies. However there are countries less endowed with energy resources (like Tajikistan) but having high energy intensity.

18 High energy intensities indicate a high price or cost of converting energy into GDP. Low energy intensity indicates a lower price or cost of converting energy into GDP. Source: Wikipedia, the free encyclopedia

19 Total Primary Energy Consumption per Dollar of Gross Domestic, Product Using Purchasing Power Parities

It is also apparent that the Uzbekistan and Tajikistan are well above the average of their region and even above the Middle East in terms of energy intensity. Kazakhstan and Turkmenistan are around the regional average. On the other hand the Caucasian countries are close to the energy intensity levels of Europe; their relatively good performance can be rather explained by the higher share of services and the lower share of industry in GDP.

Chart 7. Energy Intensity improvement in CCA countries and regions of the world, 1995-2005 (%)



Source: Energy Information Administration, own calculations

Chart 7 shows that improving energy efficiency is a general tendency all over the world. Especially in case countries of Eurasia this process is apparent. Among the CCA countries the best performers are Azerbaijan, Georgia and Armenia (Caucasus), while countries of Central Asia rather underachieved comparing with Eurasia in average, or Russia.

Reasons of relative underperformance

Several reasons for relatively poor energy efficiency can be identified. First of all energy use in housing, insulation and communal services (water, heating) are extremely inefficient and obsolete.

The other significant factor is the state of industrial equipment both in the energy sector and in manufacturing. These countries have mainly energy-intensive industrial structures using mostly outdated technologies due to their Soviet heritage.

Also, as many of CCA countries are rich in primary energy resources, they use administrative and non-market energy prices and tariffs – from several aspects reasonably. However, this leads to inefficient energy use and discourages the population and enterprises from improving energy efficiency. Of course, the situation of countries with less or no fossil fuels is different, as they are forced to take significant measures because of market based import prices.

Conclusions and recommendations

Resources saved by the more efficient use of energy can exempt resources for other not purely economic, but human development priorities within the Millennium Development Goals. Energy efficiency may go hand-in-hand with technological improvement, environmental protection and a responsible reaction to global warming, not mentioning the preparation to the depletion of currently available energy resources.

International organizations also have responsibilities to promote efforts to improve energy efficiency in transition countries by ensuring financial or technical assistance tools, consultancy etc. However, especially in CCA with significant state involvement in the energy sector, the main responsibility belongs to national governments to implement appropriate measures, based on windfall revenues from natural resources, promotional programs or legislative steps. The 4th Assessment Report of the Intergovernmental Panel on Climate Change²⁰ collects several possible measures that can be adopted by governments worldwide. Based on available good practices, a comprehensive energy efficiency strategy and action plan should be developed that deals with renewable energy, housing and transport related energy efficiency, energy saving promoting legislation and budget, among others.