

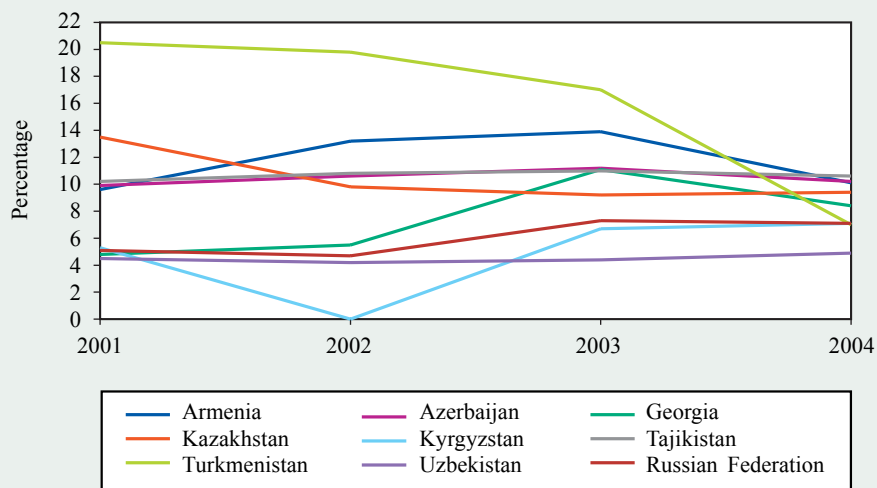
North and Central Asia

Subregional overview

For the past four years, several countries in North and Central Asia have been among the most dynamic in the Asian and Pacific region, with annual economic growth rates exceeding 9 per cent (figure II.6). Economic growth continued to be high in 2004 owing to a combination of soaring international prices of natural resources, strong exports and solid domestic demand. Growth in energy-exporting economies such as the Russian Federation, Azerbaijan, Kazakhstan and Turkmenistan exceeded previous forecasts. Strong demand from the Russian Federation helped to support economic growth in the subregion, for which it remained an important source of export demand and investment. Following a dramatic downturn in 2003, FDI for the construction of new pipelines to transport hydrocarbons from the subregion to international markets recovered sharply in 2004. The countries of North and Central Asia also made substantial progress on macroeconomic stabilization, pursuing prudent monetary and fiscal policies designed to contain inflation (figure II.7) and keep exchange rates stable.

North and Central Asian economies among the most dynamic in the region

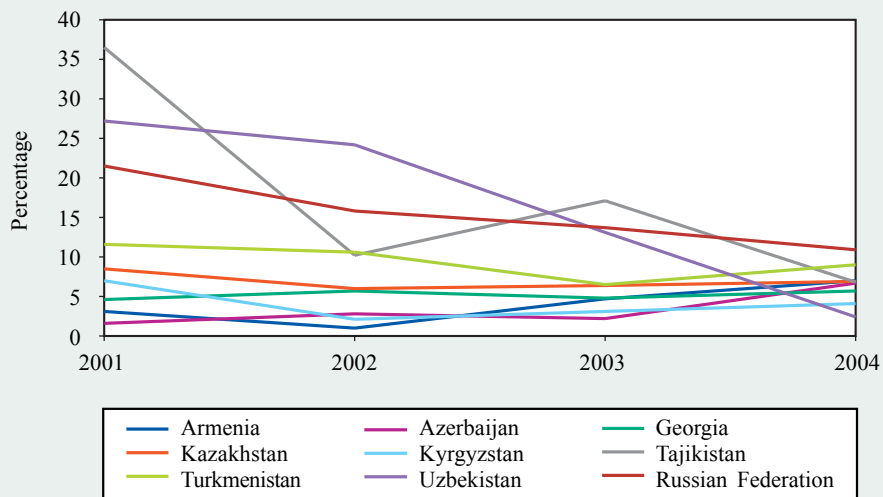
Figure II.6. Rates of GDP growth in North and Central Asian economies, 2001-2004



Sources: ESCAP, based on ECE, *Economic Survey of Europe 2004*, No. 1 (United Nations publication, Sales No. E.04.II.E.7); web site of the CIS Inter-State Statistical Committee <www.cisst.com>, 26 October 2004 and 3 February 2005; EIU, *Country Reports* (London, EIU, 2004), various issues; and national sources.

Note: Growth rates for 2004 are estimates.

Figure II.7. Inflation^a in North and Central Asian economies, 2001-2004



Sources: ESCAP, based on the web site of the CIS Inter-State Statistical Committee <www.cisstat.com>, 26 October 2004 and 3 February 2005; and EIU, *Country Reports* (London, EIU, 2004 and 2005), various issues.

Note: Inflation rates for 2004 are estimates.

a Percentage changes in the consumer price index.

Economic growth expected to fall in the medium term

The prognosis for economic growth over the next three years in the countries of North and Central Asia is based on an anticipated fall in world oil prices. Economic growth in the Russian Federation is expected to decline somewhat to 6.3 per cent in 2005 and 6.1 per cent in 2006 before recovering to 6.5 per cent in 2007. Sharper falls in GDP growth in 2005 are expected in Tajikistan and Armenia, to 5 and 6.5 per cent respectively, well below the 10-11 per cent expected in 2004. The medium-term outlook for Georgia is also for slower growth, averaging 5 per cent annually through 2008, sustained by oil and gas pipeline construction and improvements in the business climate that should foster export diversification. However, some acceleration in GDP growth is expected in Uzbekistan, to 5.3 per cent in 2005 and 6.4 per cent in 2006 from 4.9 per cent in 2004.

A gradual decline in inflation, from 8 per cent in 2005 to 3 per cent in 2008, is forecast in the Russian Federation and the pursuit of prudent monetary policies is also expected to keep inflation around 5 per cent in Tajikistan and Georgia.

Among the main policy priorities of the countries in North and Central Asia in 2004 were structural reforms to foster economic diversification so as to reduce dependence on the export of natural

resources and boost economic competitiveness by improving the business climate. Greater integration into the regional and global economies will be needed to achieve these aims and a key to this is membership in WTO. In 2004, six economies in the subregion were engaged in the negotiations process with WTO, while three others, namely, Armenia, Georgia and Kyrgyzstan, have already joined that body. The countries of North and Central Asia also continued to restore and revitalize their significant economic complementarities within three economic organizations established in CIS, the Eurasian Economic Community, the Central Asian Cooperation Organization and the Single Economic Space.

Poverty reduction and improvement in the living standards of the population remain major medium-term priorities for all the countries in North and Central Asia. Economic growth in those countries has not as yet resulted in sustained poverty alleviation and the achievement of incomes above subsistence levels. Georgia is expected to reduce the share of the population living below the national poverty line from over half of the population in 2002 to about one third in 2008 and one fifth by 2015. The strategy for improving living standards in Uzbekistan envisages further reform in all spheres and continued economic liberalization. The Government of the Russian Federation intends to cut the percentage of the population living below the poverty line from over 20 per cent at present to 10-12 per cent over the next five years.

GDP performance

Macroeconomic policies of the economies of North and Central Asia in 2004 were conducive to sustaining growth, accelerating structural reforms, containing inflation, maintaining exchange rate stability and strengthening debt management. Growth in the largest economy of the subregion, the Russian Federation, was strong owing to high oil and gas export prices and the global recovery. Domestic demand also played an important role, with fixed investment growing at double-digit rates, while strong consumer spending was sustained by rising real incomes. As a result, growth in GDP and industrial production reached 7.1 and 6.1 per cent respectively in 2004 (table II.7). The economic boom was evident in construction, which expanded 14.3 per cent in the first half of 2004, reflecting increased investment in both infrastructure and housing. Telecommunications and retailing were also among the most dynamic sectors in the economy as in 2003. Retail sales were driven by rising real incomes, which increased 12.0 per cent in 2004, in part reflecting higher revenues in the hydrocarbons sector. The economy remained heavily dependent on the energy sector, which accounted for 55 per cent of all exports in 2004. Grain production in 2004 was 16 per cent above that in 2003, with a harvest of 78 million tons, permitting exports of over 8 million tons of wheat.

***Sustained economic
growth in the
Russian Federation***

Table II.7. North and Central Asian economies: growth rates, 2001-2004				
<i>(Percentage)</i>				
		<i>Rates of growth</i>		
		<i>Gross domestic product</i>	<i>Gross agricultural output</i>	<i>Gross industrial output</i>
Armenia	2001	9.6	12.0	5.3
	2002	13.2	4.0	14.6
	2003	13.9	4.0	14.9
	2004	10.1	14.5	2.1
Azerbaijan	2001	9.9	11.0	5.1
	2002	10.6	6.0	3.6
	2003	11.2	6.0	6.1
	2004	10.2	4.6	5.7
Georgia	2001	4.8	6.0	-5.0
	2002	5.5	-1.0	7.0
	2003	11.1	11.0	14.8
	2004	8.4	-6.5	3.4
Kazakhstan	2001	13.5	16.9	13.8
	2002	9.8	3.0	10.5
	2003	9.2	1.0	8.8
	2004	9.4	0.1	10.1
Kyrgyzstan	2001	5.3	6.8	5.4
	2002	0.0	3.0	-10.9
	2003	6.7	4.0	17.0
	2004	7.1	4.1	3.7
Russian Federation	2001	5.1	7.5	4.9
	2002	4.7	1.5	3.7
	2003	7.3	1.5	7.0
	2004	7.1	1.6	6.1
Tajikistan	2001	10.2	11.0	15.0
	2002	10.8	..	8.4
	2003	11.0	..	9.9
	2004	10.6	10.3 ^a	14.3
Turkmenistan	2001	20.5	..	11.0
	2002	19.8	17.0 ^a	10.0
	2003	17.0
	2004	7.0	20.7 ^a	..
Uzbekistan	2001	4.5	5.0	7.6
	2002	4.2	6.1	8.5
	2003	4.4	4.3	6.2
	2004	4.9	10.4 ^b	9.6 ^b

Sources: ESCAP, based on ECE, *Economic Survey of Europe 2004*, No. 1 (United Nations publication, Sales No. E.04.II.E.7); web site of the CIS Inter-State Statistical Committee <www.cisstat.com>, 26 October 2004 and 3 February 2005; and EIU, *Country Reports* (London, EIU, 2004), various issues; and national sources.

Note: Growth rates for 2004 are estimates.

^a January-September.

^b January-June.

Sustained by the oil sector, Kazakhstan's GDP growth averaged 9.5 per cent in 2002-2003. This strong performance continued in 2004 with GDP growth of 9.4 per cent, reflecting a strong expansion in industrial output, owing to high volumes of oil exports and substantial FDI. Oil-related activities and new investment in infrastructure resulted in a 10.1 per cent increase in industrial output in 2004. Agricultural production increased by only 0.1 per cent in 2004 owing to a poor grain harvest that was expected to be 16 per cent below that of 2003.

Oil production dominated industrial output in Kazakhstan

Modest growth in industrial production, which reached 3.7 per cent in 2004, also contributed to sustained expansion in Kyrgyzstan's GDP of 7.1 per cent in the same period. Metallurgy and food processing were the main drivers of industrial growth, the former accounting for around half of all industrial output. Increased investment from the Russian Federation and Kazakhstan in hydroelectricity enabled Kyrgyzstan to increase capital imports. The economic growth of Kyrgyzstan also reflected vigorous expansion in the service sector. Retail trade was up by 14.7 per cent in 2004 as real household incomes rose. Gross agricultural output grew by a more modest 4.1 per cent in 2004.

Solid economic growth in Kyrgyzstan and Tajikistan

Tajikistan has experienced solid economic growth and falling levels of inflation in the last four years. The economy grew by 11 per cent in 2003 and by 10.6 per cent in 2004. The growth was largely based on the two traditional pillars of the economy – cotton and aluminium, which remained the main export items. At the same time, rapid expansion of light manufacturing, energy and services as well as private farming enabled some diversification in growth. Owing to increased inward remittances of migrant workers from Tajikistan, domestic demand was strengthened and retail trade remained robust. Industrial production expanded 14.3 per cent in 2004 and agricultural production rose 10.3 per cent in the first half of the year. However, heavy rains and landslides in the middle of 2004 affected the cotton harvest. The Government is expected to speed up land reforms in the medium term.

GDP grew 10.1 per cent in 2004 in Armenia. This was despite a relatively poor performance of the industrial sector owing to a disruption in supplies of raw materials for diamond production and a slowdown in construction. The growth rate of industrial production declined from 14.9 per cent in 2003 to 2.1 per cent in 2004. The decline was attributed mainly to a 17 per cent decrease in diamond production, which nevertheless remains a strategic sector of the economy. In the last six years, the output of this sector has increased 10-fold and the volume of diamond processing and exports are expected to double over the next three years. Agricultural production accelerated from 4.0 per cent in 2003 to 14.5 per cent in 2004 owing to improvements to the irrigation network.

Considerable decline in industrial production in Armenia

Georgia benefited from oil and gas pipeline construction

The economy of Georgia was on track to sustain the high growth observed in 2004, when GDP expanded 8.4 per cent owing primarily to new investment in construction as well as growth in other sectors such as transport and services. The construction of the Baku-Tbilisi-Ceyhan oil pipeline and the South Caucasus gas pipeline was the principal factor in the solid economic performance in Georgia in 2004. The service sector benefited from the pipeline activity, which also had important spillover effects on related sectors such as transport and communications as well as hotels and catering. Gross industrial output grew by 3.4 per cent in 2004, owing to strong growth in the extraction sector and in manufacturing. Agricultural production recorded a decline of 6.5 per cent in 2004 as farmers ran short of credit to purchase seeds and fertilizers. Implementation of the land reform initiated in 2004, which is aimed at privatizing and leasing arable land, should lead to improved performance in the sector in the near future.

Robust growth in agriculture in Uzbekistan

In 2001-2003, GDP growth in Uzbekistan was modest but steady at an annual rate above 4 per cent, sustained by robust growth in agriculture, and 4.9 per cent growth was expected in 2004. Agriculture is the dominant sector of the economy, accounting for around a third of GDP and employment, and is among the largest export earners in the country. Agricultural production grew by 10.4 per cent in the first half of 2004. The Government has reformed grain and cotton marketing and cooperative farms have been privatized. However, Uzbekistan remains dependent on wheat imports, mainly from Kazakhstan. The implementation of import-substituting industrialization and energy reforms resulted in a 9.6 per cent expansion in the industrial sector in the first half of 2004. Economic expansion in 2004 was also supported by investment from the Russian Federation and China in large projects in the hydrocarbons sector. FDI and credits also flowed to other sectors such as transport, communications, light industry, and chemicals and petrochemicals in 2004.

Hydrocarbons remained the engine of economic growth in Azerbaijan and Turkmenistan

The macroeconomic performance of Azerbaijan remained strong in 2004. Following growth of 11.2 per cent in 2003, GDP grew a further 10.2 per cent in 2004. Capital investment and construction activity linked to the development of new and ongoing oil- and gasfields and the Baku-Tbilisi-Ceyhan oil pipeline fuelled economic growth. Strong inflows of FDI into oil- and gas-related projects led to a 5.7 per cent increase in industrial production in 2004. Construction and communication services were the main beneficiary of investment inflows into the economy. Agriculture grew by 4.6 per cent in 2004 and remained the largest employer, absorbing 40 per cent of the total workforce of the country. However, the country is still not self-sufficient in food, and foodstuffs were significant import items in 2004.

The economy of Turkmenistan was expected to grow by 7.0 per cent in 2004 following a solid performance of the hydrocarbons and agricultural sectors, which continue to be the principal drivers of economic growth in the country. The strong growth was also attributed to investment in the construction of new roads and facilities in the hydrocarbons sector. The agricultural sector expanded by 20.7 per cent in the first 9 months of 2004 and the grain and cotton harvests were expected to meet the targets for the year, which have been set at their highest levels since independence.

Inflation

Monetary policy in the economies of North and Central Asia in 2004 focused on containing annual inflation. Tight monetary policy contributed to the sharp drop in the rate of inflation in Uzbekistan from 13.1 per cent in 2003 to just 2.4 per cent in 2004 (table II.8). Other factors contributing to the decline in the price level were the limited cash in circulation and the low purchasing power of the population. Inflation also fell substantially in Tajikistan, from 17.1 per cent recorded in 2003 to 6.8 per cent in 2004, owing to lower food prices and relatively stable prices of basic commodities. However, higher domestic utility tariffs and increases in the prices of fuel and services could cause inflation to reach 8 per cent in 2005.

***Inflation declined
in Uzbekistan and
Tajikistan ...***

Table II.8. North and Central Asian economies: inflation,^a 2001-2004

(Percentage)

	2001	2002	2003	2004
Armenia	3.1	1.0	4.7	7.0
Azerbaijan	1.6	2.8	2.2	6.7
Georgia	4.6	5.7	4.8	5.7
Kazakhstan	8.5	6.0	6.4	6.9
Kyrgyzstan	7.0	2.1	3.1	4.1
Russian Federation	21.5	15.8	13.7	10.9
Tajikistan	36.5	10.2	17.1	6.8
Turkmenistan	11.6	10.6	6.5	9.0
Uzbekistan	27.2	24.2	13.1	2.4

Sources: ESCAP, based on the web site of the CIS Inter-State Statistical Committee <www.cisstat.com>, 26 October 2004 and 3 February 2005; and EIU, *Country Reports* (London, EIU, 2004 and 2005), various issues.

Note: Inflation rates for 2004 are estimates.

^a Percentage changes in the consumer price index.

... but increased in other economies

Inflation in Azerbaijan was in the 1.6-2.8 per cent range in 2001-2003 but increased sharply to 6.7 per cent in 2004. The acceleration in consumer price inflation was attributed mainly to strong domestic demand resulting from high oil-related investment and increased oil export revenues. Inflation was expected to fall to 5 per cent in 2005 following the sharp seasonal decline in food prices, which comprise the bulk of the consumption basket.

Following the 4.7 per cent rate of inflation in 2003, which reflected a robust expansion in the demand for money, the Government of Armenia hoped to lower inflation to 3 per cent in 2004. However, higher global food prices exerted upward pressure on bread prices in Armenia, which, together with higher utility prices, caused the rate of inflation to reach 7.0 per cent in 2004. Annual inflation exceeded government targets for 2004 in Kazakhstan and the Russian Federation. In 2004, consumer price inflation in Kazakhstan reached 6.9 per cent, exceeding the target range of 5-6 per cent. A surge in producer prices, wage rises in the public sector and strong growth in the money supply contributed to higher prices for foodstuffs and energy products. Consumer price inflation rose 10.9 per cent in the Russian Federation in 2004 boosted by strong domestic demand, largely as a result of higher oil and food prices. Rising wages and growth in the money supply exerted additional domestic demand pressures on the economy.

Inflation in Georgia accelerated from 4.8 per cent in 2003 to 5.7 per cent in 2004, driven by higher import prices for oil and wheat. A new taxation policy introduced by the Government in 2004, which increased the operating costs of industrial enterprises, was an additional factor pushing up prices as the higher costs were passed on to consumers. A tightening of monetary policy could reduce the inflation rate in 2005. In Kyrgyzstan, consumer prices rose by 4.1 per cent in 2004 compared with a 3.1 per cent increase recorded in 2003, within the central bank's target range of 4-5 per cent. Prices of food and services were relatively stable owing to adequate supplies and prudent fiscal and monetary policies in 2004. The Government of Turkmenistan continued its policy of maintaining price controls on major consumer goods and providing basic foodstuffs and some utilities free of charge. Nevertheless, there was a significant acceleration in the price level, from 6.5 per cent in 2003 to 9.0 per cent in 2004.

Fiscal policy

Fiscal performance satisfactory in most countries

Helped in many cases by the global boom in oil and other commodity prices, the fiscal situation of countries in North and Central Asia remained essentially satisfactory in 2004, with the budget balance as a percentage of GDP ranging from a surplus of 3.8 per cent in the

Russian Federation to a deficit of 2.3 per cent in Armenia (table II.9). In Armenia, the budget deficit declined from 3.2 per cent of GDP in 2003, as the Government focused on increasing revenues through reductions in VAT exemptions and reform of the profits tax and on improving customs and tax administration so as to generate greater resources for poverty reduction in the country. However, the budget deficit in 2004 was somewhat above the target of 1.9 per cent of GDP. Additional measures are needed to improve the transparency of tax and customs operations and to strengthen the overall coherence of the tax system and the management of the tax and customs agencies.

Table II.9. North and Central Asian economies: budget balance as a percentage of GDP, 2001-2004

(Percentage)

	2001	2002	2003	2004
Armenia	-3.8	-2.4	-3.2	-2.3
Azerbaijan	-2.0	-1.2	-1.2	-1.4
Georgia	-2.0	-2.2	-1.3	-1.3
Kazakhstan	-0.4	-0.3	-0.9	-0.4
Kyrgyzstan	0.4	-1.1	-0.8	-0.6
Russian Federation	3.1	1.7	2.4	3.8
Tajikistan	-0.6	-2.4	1.0	-0.5
Turkmenistan	0.9	-2.7	-1.8	-2.2
Uzbekistan	-3.6	-0.8	-0.4	-0.4

Sources: ESCAP, based on IMF, *International Financial Statistics*, vol. LVII, No. 8 (Washington, IMF, August 2004); and EIU, *Country Reports* (London, EIU, 2004), various issues.

Note: Figures for 2004 are estimates.

Implementation of tax reforms to simplify the tax structure, broaden the tax base and eliminate tax exemptions led to fiscal stability in Georgia in 2004. The Government was able to improve tax collection, eliminate domestic expenditure arrears and increase core spending on social projects and infrastructure. The budget deficit in 2004 was expected to be close to the target of 1.3 per cent of GDP, helped also by a substantial increase in non-tax revenues and foreign grants. The Government intends to introduce a new tax code aimed at reducing tax rates and encouraging further tax compliance.

Prudent fiscal policies and tight budgetary control enabled the Government of Tajikistan to reverse the budget deficit of 2.4 per cent of GDP in 2002 and achieve a budget surplus equivalent to 1 per cent of GDP in 2003. In 2004, the Government continued with fiscal

consolidation, targeting a budget deficit of only 0.5 per cent of GDP, close to a balanced budget. In the first half of the year, however, the budget was in a surplus of 1 per cent of GDP owing to a 36 per cent increase in tax revenues.

The budget deficit of Uzbekistan declined from 3.6 per cent of GDP in 2001 to 0.4 per cent in 2003 and 2004 owing to expenditure restraint, modest wage increases in the public sector, lower energy subsidies and lower public investment. Robust gold and cotton prices and an increase in tax rates on natural resources supported budgetary revenues in 2004. In addition, the Government continued the privatization of the State-owned enterprises. In the first half of 2004, revenues from the sale of these enterprises were 80 per cent higher than in 2003. Broadening the tax base to boost tax collection remains an important policy issue.

Budget surpluses in oil-producing countries

The Government of Azerbaijan continued to pursue a sound fiscal policy and the budget deficit remained at a low level of 1.0-2.0 per cent of GDP in 2001-2004. In spite of reductions in a number of taxes, increased salaries in the public sector and higher capital expenditures, the budget recorded a surplus of 0.9 per cent of GDP in the first 8 months of 2004 which can be attributed mainly to solid growth in oil-related revenue. (The targeted budget deficit in 2004 was equal to 1.0 per cent of GDP, assuming annual GDP growth of 9 per cent and an oil price of \$20/barrel.) The State Oil Fund of Azerbaijan contributed over 25 per cent of total budget revenues in the first 8 months of 2004. The Government was expected to implement further tax reforms in order to cut tax rates on non-oil activities so as to diversify the economy.

The budget of Kazakhstan was also in surplus in the first 10 months of 2004 owing to substantial increases in tax revenues from natural resources, especially oil. For the full year, however, the budget deficit was expected to be around 0.4 per cent of GDP even though budget revenues were likely to increase as VAT and payroll taxes related to social expenditures were cut. The federal budget has been in surplus since 2001 in the Russian Federation and the surplus was expected to widen in 2004, reaching 3.8 per cent of GDP, largely as a result of higher than expected oil prices and rouble appreciation. The Government increased oil export duties to compensate for tax losses incurred in other sectors and increase budgetary revenues. The Government was also able to reduce expenditures by one fourth in the first 9 months of 2004 following the implementation of administrative reforms.

Tax reform in Kyrgyzstan

The Government of Kyrgyzstan was expected to undertake modest tax reforms in order to reduce the budget deficit from 0.8 per cent of GDP in 2003 to 0.6 per cent in 2004. The reforms included measures to extend VAT to agricultural goods and the introduction of a property tax. The Government was also expected to adopt a simplified and more

accessible tax code to reduce turnover tax on firms by one quarter as the current income tax policy has proved to be inefficient for tax collection. The budget deficit in Turkmenistan was expected to be 2.2 per cent of GDP in 2004 as a result of increased expenditure on social programmes such as the supply of gas, water, electricity and salt at no charge to the population.

Foreign trade and other external transactions

External trade

The foreign trade of the Russian Federation expanded more than 30 per cent in January-October 2004. Merchandise exports increased 34.1 per cent, to \$144 billion, and merchandise imports 34.3 per cent, to \$60 billion, in the same period (tables II.10 and II.11). As a result, the trade balance was around 34 per cent higher than in the first 10 months of 2003, when it amounted to \$63 billion. Fuel and energy commodities accounted for over 57 per cent of total exports. Other major export items were metal and metal goods (16.9 per cent), machinery, equipment and transport (7.5 per cent) and wood and paper (4.0 per cent). The rising trade surplus resulted in a higher current account surplus, which was expected to rise marginally from 8.3 per cent of GDP in 2003 to 8.4 per cent in 2004 (table II.12).

High global commodity prices boosted export earnings in most countries

Table II.10. North and Central Asian economies: merchandise exports and their rates of growth, 2001-2004

	Value (millions of US dollars)	Exports (f.o.b.)			
		Annual rate of growth (percentage)			
		2001	2002	2003	2004 ^a
Armenia	686	13.4	48.7	35.8	2.9
Azerbaijan	2 592	33.0	-6.4	19.6	35.7
Georgia	482	-3.0	1.7	38.5	48.9
Kazakhstan	12 927	-5.3	11.8	33.7	48.7
Kyrgyzstan	582	-5.5	2.0	19.8	35.8
Russian Federation	133 450	-2.8	6.1	25.1	34.1
Tajikistan	798	-16.7	13.3	8.3	20.1
Turkmenistan ^b	3 632	6.0	13.1	27.2	16.7
Uzbekistan ^c	3 128	-6.1	-8.9	24.6	15.7

Sources: Web site of the CIS Inter-State Statistical Committee <www.cisstat.com>, 11 January 2005; and EIU, *Country Reports* (London, EIU), various issues.

^a Figure for 2004 refers to January-October except for Turkmenistan and Uzbekistan.

^b Figure for 2004 is EIU estimate.

^c Figures for 2003-2004 are EIU estimates.

Table II.11. North and Central Asian economies: merchandise imports and their rates of growth, 2001-2004

	Value (millions of US dollars)	Imports (c.i.f.)			
		Annual rate of growth (percentage)			
		2001	2002	2003	2004 ^a
Armenia	1 279	-0.5	13.0	29.6	4.2
Azerbaijan	2 626	22.4	16.4	57.7	39.6
Georgia	1 144	4.2	6.0	56.5	72.3
Kazakhstan	8 409	25.9	2.1	27.7	56.1
Kyrgyzstan	717	-15.8	26.0	22.1	33.1
Russian Federation	57 263	24.0	10.0	24.0	34.3
Tajikistan	881	1.8	5.0	22.4	64.3
Turkmenistan ^b	2 512	26.6	-3.7	18.5	17.1
Uzbekistan ^c	2 367	4.6	-14.4	8.3	23.8

Sources: Web site of the CIS Inter-State Statistical Committee <www.cisstat.com>, 11 January 2005; and EIU, *Country Reports* (London, EIU), various issues.

^a Figure for 2004 refers to January-October except for Turkmenistan and Uzbekistan.

^b Figure for 2004 in f.o.b. value is the EIU estimate.

^c Figures for 2003-2004 in f.o.b. values are EIU estimates.

Table II.12. North and Central Asian economies: current account balance as a percentage of GDP, 2001-2004

	(Percentage)			
	2001	2002	2003	2004
Armenia	-9.5	-6.2	-6.6	-6.1
Azerbaijan	-0.9	-12.3	-28.3	-29.9
Georgia	-6.6	-7.4	-10.1	-10.6
Kazakhstan	-5.2	-2.9	-0.6	2.5
Kyrgyzstan	-3.4	-5.3	-2.7	-3.3
Russian Federation	11.0	8.4	8.3	8.4
Tajikistan	-6.9	-1.4	-0.3	-3.1
Turkmenistan ^a	-2.5	3.5	4.1	3.5
Uzbekistan	-1.0	1.2	8.9	8.2

Sources: ESCAP, based on IMF, *International Financial Statistics*, vol. LVII, No. 8 (Washington, IMF, August 2004) and *World Economic Outlook Databases* (Washington, IMF, September 2004); and EIU, *Country Reports* (London, EIU, 2004), various issues.

Note: Figures for 2004 are estimates.

^a Calculated based on official exchange rates.

Increased world prices of gold and cotton and rising exports of natural gas resulted in Uzbekistan recording a trade surplus of \$815 million in the first 9 months of 2004. The Government also imposed import duties on a number of foodstuffs and undertook measures to limit the import of small-scale goods in 2004 in order to accelerate the implementation of import-substituting industrialization and provide additional protection for domestic producers. Merchandise exports were expected to grow by more than 15 per cent to \$3.6 billion in 2004 compared with \$3.1 billion in 2003 while import expenditures were expected to increase 23.8 per cent from \$2.4 billion in 2003 to \$2.9 billion in 2004. Chemical products, machinery and equipment, metals and foodstuffs were the principal imports in 2004. Markets outside CIS were the main export destinations in 2004 but imports were largely sourced from CIS countries.

Despite the favourable international conditions for its principal exports, the trade deficit increased fivefold in Tajikistan to \$392 million in January-October 2004 from a year earlier. Strong economic growth and robust domestic demand led to import expenditure increasing 64.3 per cent while merchandise exports expanded only 20.1 per cent in the same period. Aluminium and cotton continued to dominate exports and benefited from high global prices. In coming years, revenues from electricity sales to neighbouring countries are expected to increase.

The construction of oil and gas pipelines in Azerbaijan increased import expenditures by 39.6 per cent in the first 10 months of 2004, exceeding export revenues by a wide margin and resulting in a trade deficit of \$45 million during that period. Export revenues grew by 35.7 per cent in January-October 2004 owing to increased demand for crude oil and refined products in the EU. Oil products remained the largest export of Azerbaijan and accounted for about 70 per cent of total export revenues in 2004. Transport equipment and foodstuffs were other important exports.

The widening of the trade deficit in Armenia was attributed to strong growth in imports of food, raw material and energy, as well as intermediate and capital goods. Exports and imports grew by 2.9 and 4.2 per cent respectively in the first 10 months of 2004. Exports increased to \$582 million and imports to more than 1 billion over the same period and the trade deficit widened from \$473 million in January-October 2003 to \$506 million in the corresponding period of 2004. The diamond-processing sector continued to be the main source of export revenues, while the metallurgy sector is beginning to play an important role in the foreign trade of the country. Diamond and metal exports accounted for more than half the total export revenues of Armenia in 2003.

*However, trade
balances
deteriorated in
some countries*

Imports of capital goods and services related to pipeline construction and other infrastructure development and energy imports for the growing industrial sector caused the trade balance to deteriorate in Georgia. The merchandise trade deficit rose from \$539 million in January-October 2003 to \$913 million in the same period in 2004. Export revenues grew strongly by 48.9 per cent owing to buoyant world prices of metals, which remained the country's principal exports, but, at 72.3 per cent, import growth was almost as fast. Turkey and the Russian Federation were the leading trade partners of Georgia in 2004.

High oil prices led to a 48.7 per cent increase in merchandise export revenues in Kazakhstan and, as a result, the trade surplus rose to \$5.4 billion in January-October 2004 from \$4 billion in the comparable period of 2003. However, economic growth and real exchange rate appreciation stimulated a 56.1 per cent increase in import expenditure in the first 10 months of 2004. The direction of trade shifted back towards CIS; exports of goods to CIS during the first 10 months of 2004 earned Kazakhstan \$3.3 billion, up 42 per cent year on year. Imports from CIS suppliers amounted to \$4.9 billion in January-October 2004, an increase of 57 per cent from a year earlier.

The foreign trade of Kyrgyzstan expanded rapidly in the first 10 months of 2004, with an increase in merchandise export revenues of 35.8 per cent and in merchandise import expenditure of 33.1 per cent. However, the trade deficit was on an upward trend, increasing \$134 million year on year to \$167 million in January-October 2004. Gold remained the principal source of the country's export revenues, accounting for almost half of total export earnings. CIS countries were the main buyers of vegetables, sugar, clothing, building materials and tobacco from Kyrgyzstan in 2004 while non-CIS countries were the main buyers of gold.

Hydrocarbons and cotton remained the most important export commodities of Turkmenistan in 2004. The trade surplus of \$501 million recorded in the first 9 months of 2004 was attributable to the high world prices and increased export volumes of these two commodities. The merchandise export revenues of the country increased to \$2.9 billion in the first 9 months of 2004. Spending on imports rose almost 30 per cent to \$2.4 billion in the first 9 months of 2004, with imports of machinery and equipment increasing 60 per cent.

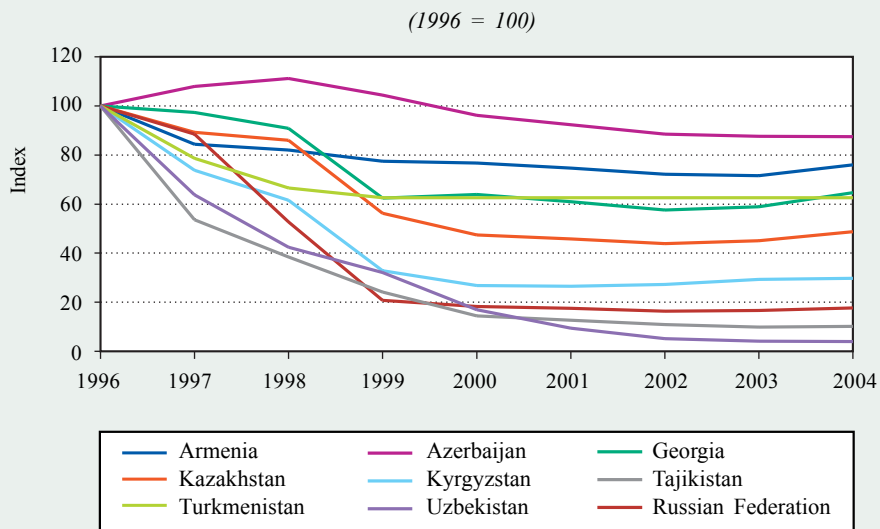
Exchange rates

Dollar weakness affected national currencies

The general weakness of the United States dollar against the euro and most other international currencies had an effect on exchange rate developments in all the countries of North and Central Asia. Countries of the subregion continued to pursue policies aimed at maintaining competitive exchange rates so as to encourage economic diversification away from oil and other raw materials.

In the Russian Federation, the nominal exchange rate of the rouble against the dollar has been relatively stable in recent years (figure II.8) but the real effective exchange rate was expected to appreciate some 8 per cent by the end of 2004 owing to high export revenues. All restrictions on hard-currency operations in the Russian Federation are to be lifted by 2007. At present, all hard-currency transactions need to be approved by the Central Bank and domestic companies are required to sell 50 per cent of their hard-currency revenues to the Central Bank. This policy has boosted the country's hard-currency reserves from under \$7 billion in 1999 to over \$86 billion in 2003. The strengthening of the rouble has had an impact on exchange rates in Central Asian countries. For example, Kazakhstan took steps to reduce the value of its currency, the tenge, in order to support export competitiveness, despite which the tenge appreciated 9 per cent against the dollar in January-September 2004.

Figure II.8. Index of exchange rates against the United States dollar of North and Central Asian economies, 1996-2004



Sources: IMF, *International Financial Statistics*, vol. LVII, No. 10 (Washington, IMF, October 2004); and ADB, *Key Indicators of Developing Asian and Pacific Countries 2004* (Manila, ADB, 2004).

Note: Data for 2004 are for January-August; in the case of Kazakhstan and Russian Federation the 2004 figures are estimates.

The increased inflow of FDI and foreign currency into the subregion resulted in national currencies strengthening in most countries of North and Central Asia against both the dollar and the euro in 2004. For example, the Azerbaijan manat and Georgian lari appreciated by 2.3 and 15 per cent respectively against the dollar in the first 9 months of 2004

Many currencies strengthened as FDI inflows increased

owing largely to substantial FDI inflows related to pipeline construction in those countries. Sustained hard-currency inflows from the sale of gas and refined oil products enabled the Government of Turkmenistan to keep the exchange rate of the manat stable in 2004. The Armenian dram appreciated by 6 and 10 per cent against the dollar and the euro respectively in the first half of 2004 but the continued high rate of inflation was expected to keep the dram relatively stable during the rest of the year. The Tajikistan somoni strengthened against the dollar in 2004 owing to substantial remittances from migrant workers and rising export earnings; the Government maintains a managed float exchange rate regime.

***Current account
convertibility
introduced in
Uzbekistan***

Uzbekistan introduced current account convertibility and loosened foreign exchange controls in the fall of 2003. Exchange rates were unified and the Government accepted its obligations under article VIII of the IMF Articles of Agreement. However, the unification of exchange rates reduced the volume of currency in circulation and both import and export of the national currency remain restricted. The tight monetary policy enabled the Government to stabilize the exchange rate of the sum by the third quarter of 2004. The currency had depreciated against the dollar by about 1 per cent each month after exchange rate reforms were introduced. The national currency of Kyrgyzstan, the som, depreciated 1 per cent against the dollar and 5 per cent against the euro in the first 5 months of 2004. The National Bank of Kyrgyzstan limited interventions in the foreign exchange market to smooth daily fluctuations and strengthen international reserves.

Capital inflows

***Resource-based
sectors received
most of FDI***

Most of the FDI inflows into the Central Asian subregion have been directed at bringing its oil and gas resources to Europe. At the same time, construction of an oil pipeline from Kazakhstan to China was launched in 2004. Kazakhstan is involved in three projects which were expected to lead to a rapid increase in oil production in the country. Since 1992, Kazakhstan has attracted nearly \$18 billion in FDI, which has become a major contributor to the country's rapid economic growth and relative current account stability. Net inflows into the country increased almost fivefold to \$1.7 billion in the first half of 2004 from a year earlier.

FDI inflows into the Russian Federation increased from \$3.5 billion in 2002 to \$6.7 billion in 2003. The bulk of the investment went to resource-based and service-related sectors. Given stable economic growth in the Russian Federation and Kazakhstan in the last five years, FDI flows between the two countries commenced in 2004. Oil companies from the Russian Federation intend to invest in developing oilfields on the Kazakh

sector of the Caspian Sea shelf and in other oil-related projects in Kazakhstan, which in turn, was expected to invest about \$1 billion in the economy of the Russian Federation in 2004.

The Russian Federation was the largest foreign investor in Armenia, accounting for over 90 per cent of \$121 million additional FDI inflows in 2003. The bulk of the foreign investment was centred in three sectors of the economy, iron ore mining, telecommunications and the food industry. In the first half of 2004, FDI inflows into Armenia amounted to \$93 million, compared with \$23 million received in the corresponding period of 2003.

More than 80 per cent of Georgia's current-account deficit was covered by inflows of FDI in 2003, which amounted to \$338 million or double the sum received in 2002 owing to the progress in constructing the oil and gas pipelines from Azerbaijan to Turkey through Georgia. The construction of the Baku-Tbilisi-Ceyhan oil pipeline brought \$3.6 billion to Azerbaijan and Georgia in 2002-2004. The current revival of FDI in energy production is also driven by rising global energy consumption and new technology. Inflows of FDI into Azerbaijan increased from \$1.4 billion in 2002 to \$3.3 billion in 2003 and, in 2004, the ratio of FDI to GDP of Azerbaijan was around 50 per cent.

The Government of Kyrgyzstan aims to increase FDI inflows to \$200-250 million by 2005 and FDI was expected to be 50 per cent higher in 2004. However, Kyrgyzstan needs to improve the business environment and strengthen cooperation in the subregion to facilitate the free flow of investment, goods and services. There is also a need to improve the country's tax legislation and make further progress on privatization and structural reforms. Two other economies, Uzbekistan and Tajikistan, need further structural reforms to attract more FDI. The levels of FDI in those countries are the lowest among the economies of the subregion owing to the poor business environment. However, there was a moderate pickup in FDI in Uzbekistan in 2003 following hydrocarbon-related investment inflows from the Russian Federation and China. Most FDI in Tajikistan in 2004 was allocated to the completion of two hydroelectric plants and development of the energy sector.

Foreign debt

Substantial oil revenues considerably increased the domestic resources available in the oil-producing countries of the subregion, namely, the Russian Federation, Kazakhstan and Azerbaijan, to carry out development programmes without significant international borrowings in 2004. High oil prices enabled the Russian Federation to repay external debt as scheduled in 2004 and create a stabilization fund. The stabilization fund was used to refinance foreign debt. The ratio of debt to GDP fell from

*External debt has
been reduced owing
to oil revenues*

more than 100 per cent in 1998 to less than 30 per cent in 2003 and was expected to fall further to 21.3 per cent of GDP by the end of 2005. Kazakhstan and Azerbaijan also built up reserves of foreign exchange and high oil export earnings enabled the latter to meet debt-service costs. Azerbaijan's external debt was moderate, accounting for 22 per cent of GDP in 2003.

Debt rescheduling improved prospects for debt servicing in some countries

Tajikistan improved its prospects for external debt sustainability and the terms of debt service through debt-rescheduling agreements with its largest bilateral creditors such as the Russian Federation, Kazakhstan and Uzbekistan, effectively replacing bilateral debt with concessional borrowing. As a result, the external debt ratio declined from 82 per cent of GDP in 2002 to about 65 per cent in 2003, which is still one of the highest among the countries of North and Central Asia.

Georgia was one of the biggest recipients of development assistance among the countries of North and Central Asia in 2001-2004, in part owing to better tax effort. Debt service amounted to just under 25 per cent of export revenues in 2003 and total external debt was \$1.78 billion at the beginning of 2004, and during the course of the year the Government reached an agreement with the Paris Club of leading creditor nations on rescheduling \$200 million in foreign debt. The country no longer intends to borrow in the medium term except on concessional terms. Kyrgyzstan, whose total external debt is currently around \$2 billion, is also expected to enter into a restructuring agreement with the Paris Club in 2005, which should result in a decline of the external debt ratio to 84.4 per cent from 91 per cent of GDP in 2004.

The foreign debt of Armenia climbed nearly 7 per cent in 2003 to reach \$1.1 billion, of which almost 90 per cent was owed to the World Bank and IMF. The conclusion of a debt-to-equity agreement with the Russian Federation in 2003 reduced external debt by about \$100 million. Debt servicing has not proved to be a problem for Armenia in 2004 owing to strong economic growth and increased export revenues.

Key policy issues

Poverty reduction efforts

There is a need for pro-poor growth in all countries of the subregion

Strong economic growth in the countries of North and Central Asia has underscored the need for pro-poor growth. While new jobs have been created and living standards improved in these countries, disparities between rural and urban areas and between the poor and rich remain. Rural poverty is three times higher than in urban areas in most Central Asian countries. Kyrgyzstan launched the first regional poverty reduction plan in the largest and most populous provinces of the country in 2004. The poverty rate in those regions was over 52 per cent, exceeding the

average national poverty rate of 44 per cent in 2004. The main aim of the plan is to reduce poverty by more than half by 2010 through revitalizing the agricultural sector, utilizing human resources more effectively, developing the school and professional education systems further and strengthening cooperation between the central and local authorities. Real incomes of the population rose as a result of the economic expansion in Kyrgyzstan in 2004, with average monthly wages rising 4 per cent in the first 7 months of the year. However, wage levels remain much lower than average wages in Kazakhstan and the Russian Federation. As a result, there has been a sharp increase in labour migration from Kyrgyzstan and some 200,000-500,000 citizens of the country sought work in other CIS countries in 2004, particularly in the Russian Federation and Kazakhstan. The official unemployment rate declined marginally from 3.1 per cent in 2002 to 3.0 per cent in 2003 and total employment increased by 1 per cent in the same period.

In terms of per capita incomes, Uzbekistan remained one of the poorest CIS countries in 2004. However, the country's social indicators appear more favourable than those of other countries with similar per capita incomes. In 2004, the Government increased the minimum monthly wage from \$5.5 to \$6.5, the monthly pension to about \$13.0 and other benefits by one third. However, over a quarter of the population of Uzbekistan is still living below the poverty line and income inequality was rising in 2004. Women make up nearly 60 per cent of the officially unemployed in Uzbekistan. The economy is expected to grow faster in 2005-2006, which will be necessary if per capita income and employment are to increase, given the rate of population growth. Despite falling birth rates, families remain large, especially in rural areas; 31 per cent of all rural families comprise 6-7 people.

Combating widespread poverty is a serious challenge facing Armenia. The Government's 12-year poverty-reduction plan seeks to reduce the poverty rate from more than 50 per cent in 2004 to 19 per cent in 2015. There were some indications of increased job creation in the country in 2004 as increased employment in labour-intensive sectors such as construction and agriculture contributed to a fall in the rate of unemployment. In 2003, 9.8 per cent of the labour force was officially registered as unemployed. The average monthly wage grew by almost a third in 2004.

The share of the population of Tajikistan living below the poverty line declined from 83 per cent in 1999 to 64 per cent in 2003. However, widespread poverty and lack of employment opportunities remain the prime social concerns of the country, which was among the poorest in CIS in 2004. In 2003, about 17 per cent of the population of Tajikistan sought jobs and higher wages in the Russian Federation and other neighbouring countries. Overseas job opportunities continued to be an important means of livelihood for many households in Tajikistan to alleviate poverty.

Some poor countries made progress in reducing poverty ...

... but job creation remains a challenge

Incomes and salaries grew rapidly in Azerbaijan in 2004, with average monthly wages and per capita incomes increasing nearly 20 per cent and 18 per cent respectively. Workers in the oil industry and related sectors, in particular, benefited from faster growth and wages increased more rapidly. However, wages in the agricultural and social sectors remained a fraction of those in the oil sector. There was limited capacity to generate new jobs in Georgia, pipeline construction being unable to absorb the high number of newly unemployed. Reducing the share of the population living below the subsistence level from just over one half in 2003 to about one third by 2008 is one of the main goals of the Government.

Monetization of social benefits in the Russian Federation

Twenty-two per cent of the population of the Russian Federation lived in poverty in 2004 and there was a wide disparity between the rich and the poor in the country. At present, the poorest 10 per cent of the population are estimated to receive only 4 per cent of existing social benefits. To make the system fairer, a law converting certain social benefits such as free public transport and medicine into cash payments was adopted in 2004. The process of monetizing social benefits is aimed at providing the elderly with a choice between continuing to receive benefits in kind or in cash. Social benefits and assistance provided by the Government affect around 70 million people in the Russian Federation but people in rural areas suffer the greatest hardships as they are unable to take advantage of free transport and medical treatment. Cash payments are expected to give them greater direct financial support from the State and enhance choice.

Economic growth in the Russian Federation in 2004 had an impact on the labour market of the economy. The unemployment rate fell from 8.7 per cent in the first half of 2003 to 8.1 per cent in the corresponding period in 2004. Nominal wages rose 21.5 per cent in the first 10 months of 2004. Traditionally low-paid sectors continue to be health and education and, in the industrial sector, light industry and textiles. The minimum monthly wage is expected to increase from \$25.7 in 2004 to almost \$40 in 2006 in line with the official subsistence level. The socio-economic development programme of the Russian Federation for 2005-2008 envisages a reduction in the proportion of the population living below the subsistence level from 22 per cent in 2004 to 5.2 per cent by 2015. During this period, income inequality is expected to decline and the ratio of the average income of the top 10 per cent of income earners to the average income of the bottom 10 per cent is targeted to fall from 14.8 to 13.5 per cent.

HIV/AIDS - an emerging issue for the subregion

The poverty issues in the countries of North and Central Asia were aggravated by other social issues such as poor health and education systems and increased vulnerability to external shocks. HIV/AIDS has become a major and growing challenge for the subregion. The epidemic has been spreading rapidly in some countries where substantial increases in the number of reported HIV infections have been recorded. For

example, the number of registered cases of HIV increased from under 100 in 1996 to more than 3,000 in 2002 in Kazakhstan, from 3 cases in 1995 to 1,500 in 2000 in Armenia and from a few cases in the 1990s to 402 cases in 2003 in Kyrgyzstan. In 2004, more than 3,600 people in Uzbekistan were registered as having HIV and the corresponding figure for Tajikistan was over 300. The rapid growth is a reflection of drug use and unsafe sex. According to some estimates, there were more than half a million drug users in Central Asia in 2004. Sexual transmission accounted for more than a quarter of newly registered HIV infections in the same year. Governments in Central Asian countries have adopted policies to diminish the spread of HIV/AIDS by encouraging prevention and also to improve treatment of infected persons. All countries have national AIDS centres and programmes on both health promotion and harm reduction. However, the HIV/AIDS epidemic could have far-reaching economic implications for the countries of the subregion. Long-term economic growth rates could fall by about 10 per cent in Kazakhstan and Kyrgyzstan and by over 20 per cent in Uzbekistan by 2015.

Banking and structural reforms

Given the important link between structural reforms and economic growth, the countries of North and Central Asia focused on policies aimed at strengthening the banking sector, removing distortions in the energy sector and reforming natural monopolies. Banking reform in the Russian Federation included measures to consolidate the banking sector through voluntary combinations and mergers of smaller banks. There were more than 1,300 small banks in the country in 2004. As a part of this policy, the process of merging banks was simplified in order to protect the interests of creditors. All banks were expected to apply to join a deposit-insurance scheme to be introduced in 2005. Under the scheme, depositors would have the right to get up to 100,000 roubles of their deposits back in the event of a bank collapse.

In Tajikistan, the recent restructuring of commercial banks and improvements in the regulatory environment covering banking operations increased public confidence in the banking system. Kyrgyzstan, however, was not able to mobilize sufficient domestic savings for its investment needs as a result of slow banking reforms and the banking system has not played a significant intermediary role between savers and borrowers. The focus of the country's banking reform in 2004 was on developing more effective procedures for settling disputes with foreign investors, banking legislation and improving banking services for SMEs.

The restructuring of natural monopolies was one of the cornerstones of structural reforms in the Russian Federation designed to reduce the economic influence of the State and make companies more efficient and transparent. Under the reform plan of the country's Unified Energy

*Consolidation of
banking sectors in
the Russian
Federation and
Tajikistan*

*Natural monopolies
and the energy
sector also focus
of reforms*

System (UES), the State was expected to retain control of the transmission grid and the generation of electricity in hydropower stations. The remaining assets of power generation and distribution entities were expected to be sold to investors. The experience in reforming UES is to be used in the restructuring of one of the largest suppliers of natural gas in the world, Gazprom, in 2005. The company is an export-oriented entity responsible for the exploration, production and transport of gas. The reform of Gazprom is expected to provide access for independent gas producers to the State-controlled gas pipeline and abolish restrictions preventing foreign investors from buying the company's domestic shares to increase market capitalization of the entity.

Georgia launched an ambitious structural reform effort aimed at addressing governance issues, improving the efficiency and effectiveness of the public sector and strengthening macroeconomic fundamentals in 2004. Restoring the physical and financial viability of the energy sector was another key element of the reform agenda. Improved bill collection is expected to reduce the sizeable fiscal deficit. The power tariff methodology has been reviewed by the energy regulatory agency to facilitate cost recovery. Structural reforms in Armenia were aimed at sustaining economic growth and reducing poverty. Reforming the energy sector was one of the policy priorities for the country in 2004 and reforms included the establishment of market rules for electricity trading and privatization of distribution companies.

Apart from the banking sector, Tajikistan's structural reform agenda is extensive and includes the privatization of the energy sector and State-owned farms to enhance resource efficiency. Farms remaining in public hands are expected to be restructured and privatized by the end of 2005 through the issuance of land-use and land-share certificates. Economic policy in Azerbaijan in 2004 focused on maintaining macroeconomic stability while implementing deeper structural reforms. Recent structural reform commitments include increasing competition in the telecommunication sector and reforms in the banking and energy sectors.

Talks on WTO membership made progress but were going slowly

WTO membership is a central plank in the economic reform programmes of North and Central Asian countries. Membership is expected to enable those countries to play a full part in global trade negotiations. Talks on access to service markets, such as telecommunications and banking, were going slowly but have made progress. In 2004, the greatest progress was shown in negotiations with the Russian Federation and Kazakhstan. These two economies could eventually become members of WTO in 2005-2006. The main obstacles to the membership of other countries were State subsidies for the agricultural sector and energy pricing and access of foreign companies to markets in telecommunications and financial services.