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Theme of the Issue: Central Asia

New Findings

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From the Editor:

Dear Reader,

Being among the most land-locked countries in the world — with distances to nearest ports exceeding 3000 km — the Central Asian states heavily depend on cooperation with neighbors and each other for economic development. The lack of cooperation in international trade, water management and other important issues, as well as poor institutional capacity were the major reasons for the meager, even devastating, performance of these countries during the first 15 years of independence (see articles by Pomfret and Asia Development Bank). Although the current situation could have been worse (Olcott, Grafe et al.), the issues of poverty and human development are really worrisome in all the countries, except for oil-rich Kazakhstan (Pomfret).

Similar to other developing countries, in the past years women have suffered the most, both in terms of access to education (Shemyakina) and access to health services (Makhmoutova). Among other vulnerable groups are the inhabitants of secondary cities, who have suffered from poverty even more than the rural population (Hamilton et al.). In the poorest countries of the region migration has become the best survival strategy. In Tajikistan remittances are estimated to be as high as 28% of GDP and have become the second most important source of revenues after aluminum exports (Hoffman). However, the institutional environment of the Central Asian countries does not facilitate the use of these remittances in the most effective ways for human development. This concerns both weak banking systems, which charge high transfer fees, and pension systems design, which does not allow for contributions from migrants (Mogilevsky).

Removing barriers to both regional and global trade seems to be the first step needed to boost development. Welfare effects of such policies can be substantial: according to Jensen's and Tarr's estimates, gains from Kazakhstan's accession to the World Trade Organization can amount to 6.7% of consumption in the medium term, and 17.5% in the long term. By opening borders, the most closed economy of the region — Uzbekistan — can increase its trade with South and East Asian countries by 10-15 times in the coming decade (Raiser and Tray). As recent growth in South-South trade shows, a more open policy will have a positive effect on trade and welfare not only in Uzbekistan, but also on most other countries in the region (Kowalski and Shepherd).

Continuing reforms, decreasing barriers to new business development, and strengthening social support systems are some other important steps towards sustainable development in Central Asia. Experimenting with new industrial policies can also be helpful if done carefully (Radosevic and Myrzakhmet).

Overall, as this issue of BT suggests, for countries with a disadvantaged location, cooperation can be the key to development. However, this has to be backed up by good institutions and political will.

Ksenia Yudaeva, Managing Editor

Martha Brill Olcott: "The states have been pretty good at keeping tensions from turning violent"

Martha Brill Olcott is a senior associate with the Russian & Eurasian Program at the Carnegie Endowment for International Peace in Washington, D.C. She has recently authored a book "Central Asia's Second Chance". Dr. Olcott has kindly shared her views with BT.

Q.: What decisions taken in Central Asia in the past 15 years ago — since gaining independence — will have particularly serious implications for the region's future?

M. Olcott: There are several decisions taken in national capitals that have had an impact on the entire region. Probably the most profound of these was the decision by Uzbekistan, following bombings in Tashkent in early 1999, to effectively close its borders with the neighboring states. This action obviously caused severe dislocations to those living in or near the border regions, but most importantly it effectively froze the development of intra-regional trade, especially since it followed relatively shortly after the government in Tashkent decided to abandon its financial stabilization program, and chose instead to support a sharply undervalued [local currency] som. This decision had a profoundly negative effect upon the economic development of Kyrgyzstan and Tajikistan in particular.

In general the decision to artificially support the Uzbek som was a harmful one, for the prospects of Uzbek economic development as much as it was for the economies of the neighboring states. Uzbekistan lost its starting advantage as a potential magnet for investment in projects in the service sector and in light engineering. And over time the on-hand-capital of small and medium sized entrepreneurs in Uzbekistan, which was relatively significant until late 1993, has almost completely evaporated.

Similarly, the decision by Saparmurad Niyazov [late president of Turkmenistan] to predicate his foreign policy on the doctrine of "positive neutrality." This policy defies explanation in terms of what it facilitated, but was quite clear as to what it impeded. Turkmenistan refused to join any regional organization (it remained in the CIS), thus further impeding the cause of regional integration.

And without this integration the size of the Central Asian/south Siberian market has been sharply reduced, and prospects for creating a strong agro-industry and textile or clothing industry, which could have provided a needed source of jobs in the region has also diminished.

Q.: The landlocked countries of Central Asia surrounded by some of the world's "hot spots" face a number of common threats/risks, such as security issues, access to other markets, water and energy resources. Yet a lot of times the countries find it difficult to cooperate on these issues. What, in your view, are the main stumbling blocks to closer cooperation?

M. Olcott: The Central Asian states recognize that they face a series of shared security threats, but they frequently define their individual national interest in ways that make regional cooperation more difficult. This was cetainly the case with regard to the situation in Afghanistan prior to September 2001, when Turkmenistan defacto recognized the rule of Taliban, and Uzbekistan, Kyrgyzstan and Tajikistan all to varying degree believed their national security directly undermined by it, because of the presence of armed anti-government factions on Afghan soil.

Similarly, while everyone in the region recognizes that the regional water basin is a common one, each country wants to use all the water available to it to advance its own direct economic interests, and hold out hope that the reluctance of any state in the region to use force against any other state will keep the situation under control.

In fact, this has pretty much been the case; the Uzbeks did mine their borders to keep Kyrgyz and Tajiks out, which led to some loss of life before this policy was reversed, and Tashkent sent planes over Toktogul dam in Kyrgyzstan to make the point that if seasonal water patterns were disturbed and they lost irrigation they were capable of a military response. But to date, especially by comparison with the south Caucasus the states have been pretty good at keeping tensions from turning violent. And if anything, the prospects of regional cooperation, at least at the level of elite dialogue have improved over time. **BT**

Economic Performance of the Central Asian Economies

Kazakhstan and Uzbekistan could become significant middle-sized economies in their own right, while the other three countries will remain minor players in the global economy

Richard Pomfret

All Central Asian countries started from fairly similar initial conditions. They were, apart from Kazakhstan, the poorest republics in the former Soviet Union and the suppliers of primary products — mainly cotton, oil, natural gas and minerals. Human capital measures, such as life expectancy or the almost universal literacy, were, however, high for the income level (Table 1).

All the five republics were almost totally unprepared for the rapid dissolution of the Soviet Union in 1991. They had no experience of nationhood before they were incorporated into the Russian empire during the 18th and 19th centuries. The indigenous capacity for economic management was limited, because during the Soviet era development strategies were determined in Moscow. All five countries suffered from broken economic ties. Attempts to maintain economic links by retaining the ruble as a common currency exacerbated the problem of hyperinflation and had been abandoned by the end of 1993.

By the early 21st century, all five countries had essentially completed the transition from central planning. Within the common bounds of resource-based economies and autocratic regimes, the five countries gradually became more differentiated as their governments introduced national strategies for transition to a market-based economy.

All the five republics were almost totally unprepared for the rapid dissolution of the Soviet Union in 1991

Along Different Trajectories

By the usual measure of economic performance, real GDP, the five countries were to varying degrees worse off during the decade after 1989, with the poorest experiencing a decline of over 50%. These dramatic numbers do not, however, fit readily with casual empiricism. Especially in the main cities of Kazakhstan, the Kyrgyz Republic, and Uzbekistan, the quality of life seemed much improved a decade after independence. The large declines in real GDP overstate the situation for two major reasons: a shift in the reporting bias from overreporting in the centrally planned economy to underreporting in the market economy, and the changing composition of output.

The brief economic profiles of the five Central Asian countries a decade after their independence looked as follows:

- *The Kyrgyz Republic* introduced the best policies in the region, but experienced disappointing outcomes. The economic performance of the Kyrgyz Republic during the 1990s was low, as living standards were eroded, both in terms of consumption levels and the availability of social support, education and social services. Even though the Kyrgyz Republic has a relatively free market economy, matched only by that of much richer Kazakhstan on the wave of its oil boom, problems arose from failure to establish the institutions necessary for a well-functioning market economy.

- *Tajikistan's* grim economic experience was largely shaped by the civil war which was waged on and off for most of the 1990s. Tajikistan's rapid growth after 1999, ongoing reforms, and much-improved internal security are all positive signs. On the other hand, Tajikistan remains the poorest country in Central Asia. The economy relies heavily on earnings from aluminum and cotton exports (which accounted for 55% and 28% of total export earnings in 2003), and the only other serious potential foreign exchange earner is hydroelectricity. Institutional change has been slow, and governance remains poor. The physical infrastructure, heavily damaged by civil war, is still in poor shape. Social collapse is highlighted by the drug problem and migration which both threaten the once-strong family structure.

Table 1. Economic and Social Indicators, 1989–91 and 2002

	Population (mln)		Gini coefficient		Life expectancy (years)		GDP per capita, PPP
	mid-2002	1990	1989	2002	1991	2002	2002
Kazakhstan	16.8	15.5	0.289	0.35 (1996)	69	66	5,870
Kyrgyz Republic	4.4	5.1	0.287	0.46 (1996)	66	68	1,620
Tajikistan	5.3	6.2	0.308	0.47 (1999)	69	69	980
Turkmenistan	3.7	4.8	0.307	0.41 (1998)	66	67	4,300
Uzbekistan	20.5	25.7	0.304	---	69	70	1,670

• *Uzbekistan* is characterized as a slow reformer. During the 1990s it had the best economic performance of all Soviet successor states, which mainly seemed to be due to good governance, at least by the low standards of the region. An important difference between Uzbekistan and Russia or Kazakhstan was the degree to which resource rents were privatized. The Uzbek government used the revenue to maintain public spending on education and health care better than in other CIS countries. The years 1996-2002 were characterized by minimal economic reform and increasing political repression. As the economy's performance lagged in the early years of the 21st century Uzbekistan's economic performance was less impressive and the government's popular support waned.

• In *Kazakhstan*, higher income levels, more abundant human capital and natural resources were enduring advantages. With new oil fields being developed and with new pipelines providing alternative outlets for Kazakhstan's oil, the prospects for substantial oil revenues in the medium term are promising. Despite anemic growth in the 1990s, it has since 2000 enjoyed an oil boom and is now by far the richest country in the region. The elite, although it derived its wealth and power from an unfair and distorted privatization process, is now keen to establish the rule of law in order to protect its economic gains.

• At the other extreme, *Turkmenistan*, despite its natural-resource wealth, faced the grimmest immediate prospects with a regime that pursued poor economic policies and was resistant to change. On the basis of its small population and abundant natural gas, the country after independence claimed to be the "Kuwait of Central Asia". The reality has been a highly personalized regime living off resource rents, with nothing like the level of competent economic management of Kuwait. From the perspective of the economy, almost any change would have to be better than Turkmenbashi's policies.

Increased Inequality

In all five countries the move to a market economy was accompanied by increased inequality. This translated into high poverty rates in almost all Central Asian countries but Kazakhstan, which with its relatively high initial income has the least absolute poverty.

Who have been the winners and losers from the changes? Those in power have become wealthy, converting the privileges of the Soviet era into material wealth, and in some cases a new class of rich businesspeople arose from the unequal privatization of state assets or from illegal activities. At the same time rural households, large families and people with lower educational attainment have lost in most countries.

Based on household survey data, we find that three major factors determined per capita household expenditure during the transition:

• *Location*. In the Kyrgyz Republic, rural households' per capita expenditure is on average 26% lower than that of urban households. In Kazakhstan, living standards are highest in the north and lowest in the south. Environmental issues also matter, for instance in areas like Dashoguz in Turkmenistan or the Karakalpakstan autonomous republic in Uzbekistan or South Kazakhstan widespread poverty is exacerbated by the negative effects of the desiccation of the Aral Sea.

• *Household composition*. The costs of large households are substantial. A recurring result is that additional children lower per capita household expenditure by a larger amount than additional elderly or middle-aged adults do. In Kazakhstan, an additional child reduces per capita household expenditure by 17%, an elderly adult by 12%, and a middle-aged adult by 6%. In Tajikistan, each additional child reduces per capita household expenditure by 9%, each additional elderly adult by 5%, but additional middle-aged adults do not affect per capita expenditure.

• *Education* brings greater material reward in the market economy. In the shift from central planning, people with high-level general education have been best able to take advantage of new opportunities. In Kazakhstan and in the Kyrgyz Republic, per capita expenditure is 27-29% higher in households with a college-educated head than in households whose heads failed to complete secondary school and this effect is still larger in the Fergana oblast of Uzbekistan (43%). By contrast, narrower technical education has left many with obsolete skills yielding no returns in the market.

The greatest uncertainty, and potential catalyst for economic change, in the five countries concerns the political regime

Prospects

The five countries have changed substantially, with the possible exception of Turkmenistan, from the centrally planned economies, and are likely to continue moving along different trajectories. Kazakhstan remains the most likely to succeed. Both Kazakhstan and Uzbekistan could become significant middle-sized economies but in their own right rather than as part of Central Asia. However, unless Uzbekistan addresses the interconnected issues of currency convertibility, farmgate prices, and government revenues, its economy could easily slip into the stagnation familiar from many import-substituting countries of the 1950s and 1960s.

The three smaller countries will remain minor players in the global economy. Establishment of effective public administration and the rule of law in the Kyrgyz Republic and Tajikistan are necessary preconditions for progress. However, even with these conditions met, these countries' economic prospects are not good, as both are poor landlocked countries whose economic potential depends upon good regional relations to export.

In all the five countries the greatest uncertainty, and potential catalyst for economic change, concerns the political regime. Loosening of state control over the economy may be inseparable from political reform, which allows more freedom and pluralism.

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Regional Cooperation in Trade

How can regional cooperation help the Central Asian countries increase gains from trade?

Asian Development Bank

The constituent members of the Central Asia Regional Economic Cooperation Program (CAREC) — Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan — are all relatively small economies. Therefore, they need to promote trade and closely integrate into the international trading system to achieve sustainable economic development. Regional cooperation agreements can help the countries of Central Asia liberalize trade policy at relatively low costs, reduce the risks of protectionist measures by trading partners, create new trade, and improve social welfare. However, such agreements, depending on their design, can also divert existing trade, worsen social welfare and hinder the countries' full integration into the international trading system. Regional cooperation in transport and customs transit is unambiguously beneficial, given the countries' landlocked status.

Progress in any of these areas will have a limited positive impact on trade if there is no progress in others. For example, liberalization of trade policy by one country and a nonadjacent trading partner will not boost their bilateral trade much if movements of transport and goods through connecting countries remain difficult or impossible due to deficiencies of transport infrastructure. Likewise, improvements in transport infrastructure and transit systems in neighboring countries will do little to closely integrate a country into the international trading system if its trade policy remains restrictive.

Recent Merchandise Trade Performance has been Mixed

Following sharp fluctuations in the late 1990s caused by swings in world commodity prices and the 1998 Russian financial crisis, both merchandise exports and imports expanded considerably in all four Central Asian countries in 2000-2004. By 2004, their overall level of trade (the ratio of merchandise exports plus imports to GDP) was higher than what one would expect given their small size, landlocked location, and per capita GDP (see Table 1). However, a handful of primary commodities, such as crude oil, metals, and cotton fiber, continued to dominate exports, and this makes the Central Asian countries vulnerable to abrupt swings in world commodity prices.

At the same time, the participation of the Central Asian countries in global production networks and related trade in manufactured products remained very limited.

Furthermore, Central Asian countries mainly traded with a small number of countries, with which they have close historical and cultural links and/or to which they are closely located, such as China, Russia and Turkey. An analysis based on the gravity model suggests that there is a significant unrealized potential for trade between Central Asia and most East and South Asian and Western European countries. Concentration of trade partners makes the Central Asian countries vulnerable to changes in import demand in, and possible trade sanctions by, their trade partners.

Barriers to Trade are High

The Central Asian countries had very similar trade policy regimes at the time of their independence, but these have diverged significantly since then. Today, trade policy regimes vary widely from the very liberal in the Kyrgyz Republic to fairly liberal in Kazakhstan and Tajikistan, to quite restrictive in Uzbekistan.

Tariffs are fairly low and uniform in the Kyrgyz Republic and Tajikistan. Kazakhstan has a rather complex tariff schedule with a large number of tariff bands and a high maximum tariff rate although its nonweighted average tariff rate is not high. Uzbekistan has a complex tariff schedule and a relatively high nonweighted average tariff rate. A serious problem with tariffs in Kazakhstan, Tajikistan, and Uzbekistan is that changes in tariff schedules are rather frequent and unpredictable. Also, tariffs rise with a degree of processing in all the countries.

In addition to explicit tariffs, some imports to Kazakhstan, and Uzbekistan are subject to implicit tariffs in the form of taxes levied on imported goods but not on domestically produced goods or have higher rates for imported goods than for domestically produced goods.

Other significant barriers to trade are high transport costs and long and unpredictable transit times for international shipments to and from the region. This is not only due to the landlocked and remote location of Central Asia and its difficult topography but also to deficiencies of transport networks, and the high costs and low quality of transport and logistics services in the region. For exam-

Table 1. Actual and Predicted Ratios of Merchandise Exports plus Imports to GDP, 1999 and 2004 (in percent)

	At current prices				At PPP-based valuation			
	1999 actual	1999 predicted	2004 actual	2004 predicted	1999 actual	1999 predicted	2004 actual	2004 predicted
Kazakhstan	56.2	66.4	80.7	71.5	15.5	18.1	29.5	25.3
Kyrgyz Republic	84.8	69.4	76.6	72.0	14.8	11.9	16.8	13.9
Tajikistan	124.5	64.7	110.5	68.1	30.1	7.6	29.1	10.4
Uzbekistan	33.9	59	78.9	55.4	16.1	9.2	16.8	10.2

Tariffs (As of January 1, 2006)

	Number of tariff bands	Maximum rate (%)	Non-weighted average rate (%)
Kazakhstan	10	100	7.4
Kyrgyz Republic	5	15	5.1
Tajikistan	4	15	7.5
Uzbekistan	4	30	14.5

ple, the actual transport costs for shipments by road from Istanbul, Turkey to Central Asia are about 2-3 times as expensive, while the actual transit time is 1.5-2 times as long as those in a world with balanced transport flows, competitive markets for transport services, smooth border crossing, low transit fees, and no visa problems. Transport costs of exports, as a percent of exports, vary from 10% in Kazakhstan to 14% in Tajikistan; while transport costs of imports vary from 8% to 10% in the same countries, respectively.

A Plethora of Ineffective Regional Trade Agreements

Since 1991, the Central Asian countries have joined several regional organizations that involve a multilateral regional trade agreement. They have also entered into numerous bilateral trade agreements with other CIS countries. Most regional trade agreements, however, have a narrow coverage and complex rules of origin, and many have largely remained on paper only.

An analysis based on a computable general equilibrium (CGE) model of Kazakhstan suggests that implementing the Eurasian Economic Community customs union with a rise in Kazakhstan's external tariffs would substantially slow down its GDP growth. The cumulative shortfall in real GDP over ten years would exceed 31% of GDP in the base year. Implementing the EAEC customs union even with a reduction in Kazakhstan's external tariffs would slow down the growth of real GDP, but the adverse effects on economic growth would be much smaller.

Benefits of WTO Membership

In parallel with participation in various regional agreements, the Central Asian countries have pursued membership in the WTO. The Kyrgyz Republic is already a WTO member. The other countries are at different stages of the accession process. The potential benefits of WTO membership are many:

- Liberalization of trade policy at relatively low costs and a rapid expansion of trade due to improved access to markets of the WTO members;
- Diversification of trade flows towards countries with which Central Asia currently "under-trades", including most developed countries and emerging market economies in Asia;
- Reduced vulnerability to possible protectionist measures by trading partners and irreversibility of trade liberalization;
- Strengthened bargaining power in trade negotiations, especially with countries seeking WTO membership;
- Strengthened capacity for policy management and improving the quality of institutions.

WTO membership does not preclude regional cooperation in trade policy. In fact, there are several options for such cooperation. First, the Central Asian countries may want to liberalize trade policy in a coordinated manner and on a nondiscriminatory basis. Second, those of them that are not yet WTO members may want to coordinate their negotiating positions in the accession process with each other and with other countries seeking WTO membership. Third, once they become WTO members, the Central Asian countries may want to join issue specific coalitions within the WTO, such as the groups of developing countries pressuring for changes in WTO rules on agriculture and elimination of agricultural subsidies in developed countries.

Acceding to the WTO is, however, not enough to realize the benefits of WTO membership. As the experience of the Kyrgyz Republic shows, good transport links with other WTO member countries and easy transit through neighboring countries are also necessary.

Regional Cooperation in Transport and Transit

Quantitative estimates based on a CGE model of the Kyrgyz Republic show that the Central Asian countries would reap considerable benefits from regional cooperation in trade policy within the multilateral framework and increased regional cooperation in transport and customs transit.

A reduction in cotton subsidies in developed countries and a resulting rise in world cotton prices and reductions in transport costs would substantially accelerate economic growth in the Kyrgyz Republic. If world cotton prices rose by 35% in 2006, the cumulative growth of real GDP in 2006-2015 relative to 2005 would be 33.4% higher than in the baseline scenario. If the estimated reductions in transport costs due to increased regional cooperation in transport and customs transit took place in 2006, the cumulative growth of real GDP would be 112.3% higher than in the baseline scenario. If both events occurred in 2006, the cumulative growth of real GDP would be 150.2% higher than in the baseline scenario. By comparison, a 50% unilateral, nondiscriminatory, and uniform reduction in tariffs would speed up the cumulative growth in real GDP over the decade by a relatively modest 27.6%.

Unilateral nondiscriminatory trade liberalization would have greater positive effects on Kazakhstan, Tajikistan, and especially, Uzbekistan because their tariffs are, on the average, higher than those of the Kyrgyz Republic. Tajikistan, which suffers from especially high transport costs and long and unpredictable transit times, is likely to benefit even more than the Kyrgyz Republic from increased cooperation in transport and customs transit. Tajikistan and Uzbekistan are likely to gain more than the Kyrgyz Republic from a reduction in cotton subsidies in developed countries since cotton accounts for a larger share of their exports and GDP.

The piece is based on the 2006 Asian Development Bank report titled "Central Asia: Increasing Gains from Trade through Regional Cooperation in Trade Policy, Transport, and Customs Transit". The report also covers Azerbaijan, which is a member of CAREC Program, and does not cover Turkmenistan, which is not a member. The report was prepared by a team of experts led by Bahodir Ganiev. The full text of the report is available at www.adb.org. **BT**

Impediments to Trade in Central Asia

The Central Asian countries are still quite closely integrated and have porous borders

Clemens Grafe, Martin Raiser and Toshiaki Sakatsume

With the collapse of the Soviet Union the dynamics and structure of trade patterns have changed quite substantially. New and significant trade barriers emerged, including tariffs and differential excise taxes, difficulties crossing borders, corruption among customs officials and the traffic police. Yet despite changes in the direction of trade flows, former Soviet republics are still considered to be excessively integrated and "overtrading" among themselves.

In assessing the real size and impact of regional trade barriers in Kazakhstan, the Kyrgyz Republic, Tajikistan and Uzbekistan we focus on the most obvious economic manifestation of barriers to trade — the fact that prices for tradable goods will differ significantly across countries when arbitrage is not profitable due to trade barriers.

Well-integrated regions inside one country should offer only limited arbitrage opportunities, i.e. the difference of prices in two locations should only reflect different pricing of non-tradable goods and transport costs. If the two regions are located in different countries, a so-called border effect may be present, which is explained by tariff and non-tariff barriers to trade, non-integrated labor markets or distribution networks that do not extend across borders. Prices may also differ because of changes in the nominal exchange rate that are not transmitted immediately to consumer prices.

Two data sets — regional disaggregated consumption price indices, and a price survey of around 30 tradable consumer goods across all the countries — allow us to analyze price dispersion and directly compare absolute price differences across various locations. We can thus estimate the degree of trade integration from the perspective of price levels as opposed to the use of volume data, which suffers from significant under-reporting due to shuttle trade in the Central Asian context.

Small Costs of Crossing a National Border

The results of our analysis based on the first dataset show that:

- Price dispersion is generally greater between Uzbekistan and its neighbors than between Kazakhstan and the Kyrgyz Republic. However, almost the entire estimated border effect is due to trend changes in the bilateral real exchange rates;
- The estimated border effect between any pair of countries is relatively low compared to estimated effects calculated for other developing countries, although higher than that between Canada and the United States;
- Prices in northern Kazakhstan, which is more integrated with Russia than with the rest of the country, diverge from other regions by more than average;
- There is no evidence that being located in the Ferghana Valley, where distances are very short and national territories highly contiguous, has a particular impact on price dispersion and the border effect.

The fact that borders seem to matter less than is often thought in Central Asia is also confirmed by the second data set. We looked at absolute differences between prices for specific products and related these to geographical distance, the border effect and specific product characteristics. The following results stand out:

- Local factors are in many cases more important than national borders. However, the border effect is significant and positive for most locally produced agricultural goods at the Kazakh and Kyrgyz border;
- The difference between the minimum and maximum price is larger in Kazakhstan and Tajikistan than in Uzbekistan and the Kyrgyz Republic. In other words, domestic markets are more integrated in the latter than in the former two countries;
- Maximum price differences are actually quite large: price margins tend to be in the range of 30-50% and sometimes reach more than 100%. Moreover, the maximum differences are found between the cheapest and most expensive location within Kazakhstan rather than between two locations in different countries;
- In Kazakhstan, the Kyrgyz Republic and Tajikistan, the capital cities are among the cheapest locations in each country, whereas Tashkent is the most expensive city in Uzbekistan, probably due to remnants of price control leading to an implicit subsidization of less economically advanced regions;
- Distance is a significant determinant of relative prices for locally produced goods such as agricultural products, less so for branded products such as chocolate, instant coffee or mineral water;
- Distance-related costs are less important in the Kyrgyz Republic and Uzbekistan than in Kazakhstan.

Conclusion

All this confirms that, contrary to prior expectations, the Central Asian countries are still reasonably closely integrated, their borders are porous, and constitute much less of a barrier to trade than is often thought. Shuttle trade seems to be effective in taking advantage of arbitrage opportunities in consumer goods markets.

The costs of crossing a national border are small relative to the costs of crossing the vast territory of Kazakhstan or the mountains of Tajikistan. Indeed, trade barriers beyond the border remain significant obstacles for market integration both within countries and within Central Asia. Internal barriers to trade such as numerous roadblocks and attempts by local governments to restrict access to local markets and bazaars are driving up price differences across regions to levels that are at least as high as differences across countries.

Clemens Grafe is an economist for Union de Banques Suisse and lecturer at Birkbeck College; Martin Raiser is Economic Advisor in the World Bank's Country Office in Ukraine and was the country manager for Uzbekistan at the World Bank when this article was written; Toshiaki Sakatsume is an economist at the European Bank for Reconstruction and Development (EBRD). The views expressed in this paper are those of the authors only, and not of their respective institutions. Full text of the paper can be viewed at: www.ebrd.com/pubs/econo/wp0095.htm **BT**

The Impact of Kazakhstan Accession to the World Trade Organization

Kazakhstan's gains from WTO accession could be as high as 17.5% of consumption in the long run

Jesper Jensen and David Tarr

Kazakhstan's accession process to the WTO started in 1996, when the Working Party was established. Since 2004, the accession negotiations have acquired increased momentum. While Kazakhstan's tariff structure is not highly distorted, barriers to foreign direct investors in several key business services sectors remain significant and are the most important areas of negotiations between Kazakhstan and the WTO Working Party.

Our study accesses the consequences of WTO accession for Kazakhstan, identifies winners and losers, and key sources of gains. We also examine where potential reforms can do the most to boost the competitiveness of the Kazakh economy. For these purposes we develop a 56 sector "small open economy" computable general equilibrium model of the country.

The model not only numerically assesses the liberalization of barriers against foreign direct investors in business services but also examines the impact of local content policies and specialized VAT treatment on multinational oil producers. Currently, multinational oil producers that invest in Kazakhstan are encouraged to purchase Kazakh inputs. This practice is controversial, since some WTO Working Party members have questioned whether this is a "local content" requirement in violation of the WTO agreement on Trade Related Investment Measures (TRIMs). Ironically, some multinational oil producers have negotiated a waiver of the 15% VAT on their imported inputs, a practice that has offsetting effects to the local content provisions on local input use by the multinationals.

In our general WTO scenario we assume that barriers against foreign direct investment are reduced by 50%; basic metals and metal products, which are subject to antidumping actions in export markets receive slightly improved market access; the tariff rates of all sectors are reduced by 50%. In the oil sector, we assume local content requirements are eliminated, and we also assume neutral VAT treatment of local and imported inputs by extending the VAT waiver to local inputs purchased by the multinationals.

Annual Gains from WTO Accession almost 10% of GDP

We estimate that the gains to Kazakhstan from WTO accession amount to 6.7% of Kazakhstan consumption (or 3.7% of GDP) in the medium term, and could be as high as 17.5% of Kazakhstan consumption (9.7% of GDP) in the long run. The decomposition of the gains shows that they derive from four key effects:

- Tariff reduction on goods, which improves domestic resource allocation and increases the number of varieties of imports. Numerically, this factor is responsible for 0.4 percentage points of the gain in consumption.
- Improved access to the markets of non-CIS countries, which accounts for 0.5 percentage points of the welfare gain.
- The elimination of local content policies for multinational oil companies combined with VAT exemption on their input purchases from domestic sources — these result in a gain of welfare equal to 0.9% of consumption.
- Liberalization of barriers to FDI in services sectors, which increases the number of service varieties available and increases total factor productivity in sectors that use business services. This accounts for 4.9% of the value of consumption, or over 70% of the total gains from Kazakhstan's WTO accession.

Thus, while improving its offer to foreign services providers within the context of the GATS may be a difficult aspect of Kazakhstan's negotiation for WTO accession, our estimates suggest that liberalization of barriers against FDI in services sectors will bring the highest welfare gains.

Exporters the Biggest Winners

Based on our estimate results we find that:

- The sectors that will expand the most are those that export a large share of their output, such as electrical equipment, chemicals, crude oil and gas, basic metals and communications equipment (see Table);
- The sectors that will contract the most include the most protected sectors (e.g. medical equipment) and those that export less than 5% of their output, such as wood products, vehicles, non-metallic products and publishing;
- In business services, multinationals will have a greater presence, and output, including multinational output, increases. In some business services sectors, such as communications, financial

Impact of WTO Accession on Industry and Labor, Selected Sectors (Percentage Change)

	WTO accession in the medium term		WTO accession in the long term	
Sector	**Output**	**Labor**	**Output**	**Labor**
Crude oil and gas	15	20	16	12
Chemicals	11	10	8	1
Electrical equipment	46	42	64	50
Publishing	-17	-18	-16	-21
Vehicles	-16	-17	-23	-27
Medical equipment	-19	-21	-9	-17
Communications	10	6	15	6
Financial intermediation	6	4	18	7
Land and pipeline transport	6	1	14	2
Air transport	-13	-16	-9	-17

Source: authors' calculations

intermediation and land transport, the demand for labor also increases, due to multinational firms' increase in their demand for Kazakh labor. At the same time, demand for labor will decline in water and air transport services, where multinational entrants will use the local labor less intensively than the existing Kazakh firms.

The above suggests that domestic lobbying interests within the service sector could be diverse regarding FDI liberalization. We estimate that labor should find it in their interest to support FDI liberalization even if capital owners in the sector oppose it. But capital owners themselves may have diverse interests depending on their prospects for joint venture partnerships with multinationals.

Barriers in the Services Sector Still Large

Kazakhstan has done more to lower its tariffs on goods than it has to liberalize its barriers to FDI in services sectors. The services sector provide crucial inputs to the manufacturing sector and are key to the development of a Kazakh economy capable of competing on the global marketplace. In this context, we have prepared policy notes on the telecommunications (see box), financial services and transportation sectors. Given the external pressure that accompanies WTO accession, the accession process represents a unique historical opportunity to not only commit to liberalization of the foreign direct investment regime, but also to implement complementary reforms of the domestic regulatory framework.

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Using WTO Commitments in the Telecom Sector Effectively

The government of Kazakhstan is aware that an efficient — low-cost, high-quality — telecommunications sector is one of the critical determinants of export competitiveness. This is especially true given that currently calls to the US from Almaty cost two times the cost of calls from Moscow and 3.5 times on average the cost in the newly acceded EU 8 countries. Also the number of lines per 1000 inhabitants is 2.6 times larger in EU 8 countries than in Kazakhstan and almost twice as high in Russia.

The WTO accession process can be used to address the key problems that are reducing the effectiveness of the sector. The most important areas of reform include:

- *Competition*: Strong restriction on entry and foreign ownership to 49% ensures the monopoly provision of key services. One way to effectively use the WTO accession process would be to allow majority foreign ownership in the GATS commitments. The existing level of cross ownership in the sector also limits competition. Shortening the period of exclusive (monopoly) rights in the WTO offer could provide a timely and strong signal to domestic players to prepare for a liberalized market. Investors will receive assurances of greater security and predictability in the rules-based environment that WTO membership represents.
- *Regulation*: The WTO requires that the regulator be independent of the operators. Therefore the role of the agency as "manager" of state assets in the sector must be transferred to another body prior to the membership. The current institutional structure fragments policy making over three agencies and at the same time endows the key agency with significant functions outside its core mandate, such as the administration of a large e-government program. The regulator should focus on the core regulatory functions, such as regulation of competition, scarce resource and tariffs, as well as licensing and dispute resolution. Due to different technologies, telecommunications regulation must be sector-specific, to fixed line and mobile. But the competition regulation authority in telecommunications is vested in two different entities, neither of which is the telecommunications regulator.
- *Tariffs*: The existing distorted price regime redirects significant resources from non-telecommunications sectors into the telecommunication sector. Under the approved plan to increase the cost of domestic calls, and reduce the cost of international calls, tariffs will not realistically eliminate the existing major price distortions within the next 15 to 20 years. The progressive re-balancing of tariffs, including lowering interconnection charges is necessary for the market players to make economic investment decisions.
- *Universal Access*: The state-owned companies argue that they lose money on providing services in rural and remote areas. The Universal Services Fund, set up by the government, collects contributions from fixed line operators and provides funds to the two operators to compensate for their losses. The current practice has the following shortcomings:

- The regulator determines not the particular level of services, but the type of equipment to be used. Instead, universal service programs need to be technologically neutral.
- The program funds recurrent costs rather than just investments. Instead, subsidies may be justified to meet part of the investment cost, but not to compensate for recurrent service losses. Investments that are unlikely to become commercially sustainable on their own after limited initial support are rarely undertaken.
- The incumbent Kazakhtelecom does not provide information on the cost of the services and receives a subsidy that lacks transparency.
- To have true participation from all operators, and to maximize the choice of technology, the universal service program should complement and follow economic and telecom sector reforms, particularly the liberalization of the supply side of the telecom market. Only then does it make sense to use subsidies to extend service beyond what companies are prepared to do on their own.

Source: "The impact of Kazakhstan accession to the World Trade Organization : a quantitative assessment" by Jesper Jensen and David Tarr. **BT**

Uzbekistan — in the Slow Lane of the New Silk Roads?

Moving Uzbekistan to the fast lane in regional cooperation is a question of leadership and political will

Martin Raiser and Dennis De Tray

From the days of the famed Silk Road, the area that is now Uzbekistan has traded or been an important transit route for trade. With this illustrious trading history why is Uzbekistan seen today as the missing link, a major barrier in the efforts to increase trade among the Central Asian states? The reasons lie in what changed and what did not change following independence in 1991.

The change came in the form of a series of programs launched by President Karimov to dampen if not remove entirely Uzbekistan's dependence on others. Self sufficiency was the touchstone of Uzbek economic policy and import substitution its key instrument. As the experience of many other countries shows, inward looking policies tend to produce economies that are distorted and inefficient, making it ever more difficult for those economies to open up. This is the position in which Uzbekistan finds itself today.

What did not change following independence were Uzbekistan's location and its population. Uzbekistan remains an important bridge for transport from south to north, from east to west. Stalin's infamous jigsaw borders in Central Asia exacerbate the problem and make getting around Uzbekistan more expensive. Uzbekistan is also the most populous of the Central Asian states, and a potentially important internal market for the region.

As Uzbekistan's neighbors have begun to embrace the opportunities that opening up to the world brings, and as the world's major trading powers have "discovered" Central Asia's potential for trade and transit, the opportunity costs of maintaining Uzbekistan's position have visibly increased. And indeed, things may be slowly improving, which creates opportunities for Uzbekistan and for the region.

Trade and Transit Opportunities for Uzbekistan

- *Greater Openness Overall.* The past 15 years have seen a significant opening up of the region, when measured in total trade volumes. Uzbekistan was initially an exception to this trend, but the country has started to catch up in terms of total export and import levels. Today, Uzbekistan's total trade stands at around 70% of GDP at market exchange rates, a little below the CIS average, but well up on the trough of just 50% recorded in 2002.

Nonetheless, it appears that Uzbekistan is still not fully utilizing its potential to trade both regionally and with the global economy. Calculations made by the IMF in 2005 suggest that one of the main reasons for Uzbekistan's "undertrading" relative to potential may lie in its own restrictive trade policies; if the trade policies were as liberal as those in the rest of the CIS, the country could increase its overall trade by at least US$2 billion.

Taking statistical under-reporting into account, and with the recent significant rise in exports and imports, it is perhaps a safe estimate to assume that Uzbekistan's total level of openness still falls around 10-20% short of its potential. Over the period to 2015, for instance, this implies potential increases in Uzbekistan's exports and imports from US$9 billion today to around US$15 billion if GDP continues to grow at the recent average (1998-2005) of 5%.

- *Geographic Reorientation of Trade.* Uzbekistan's dependency on Russia has remained very significant, with around 22% of reported exports and 27% of reported imports going to and coming from Russia (according to the IMF Direction of Trade Statistics). Both shares have increased in recent years and are now close to what they were in the mid 1990s.

By contrast, there seem to be huge unexploited trade opportunities with South and East Asia. In 2004, Uzbekistan's trade with India was around one tenth of its trade with China, and less than 5% of its trade with Russia, although India is not considerably further away than either China or Russia, and has a similarly dynamic, growing economy. The numbers for Pakistan are also disappointing.

A gravity model analysis confirms that Uzbekistan is under-trading with South and East Asia by a factor of perhaps 10-15 times, with the notable exception of China, which has greatly increased its economic presence all over Central Asia in recent years, and South Korea, which has historically played an important role in Uzbekistan's economy. In monetary terms, and using the estimates of total trade of US$15 billion in 2015, Uzbekistan's trade with its neighbors in Central Asia, Russia, China, and South Asia may amount to over US$10 billion in that year. Trade with India may grow to US$1.5 billion, trade with China could by that time exceed trade with Russia, and Iran, Pakistan and Afghanistan could together account for up to US$1billion.

- *Greater Inter-continental Transit Trade.* The key to realizing the vision of a new land bridge between Europe, China and India through the wider Central Asia is the construction of new transport links, as investments in the preceding century have been almost exclusively directed towards integration with Russia. Presently still, almost all roads lead to Moscow. Most of the attention has been concentrated on unlocking the roads south from Central Asia, and providing access through the region to the new deep water ports in Pakistan and Iran.

For Uzbekistan specifically, this presents both an opportunity and a challenge. The opportunity is that geographically Uzbekistan sits right in the middle of Central Asia. With a less mountainous topography than that of the Kyrgyz Republic or Tajikistan, it is a naturally preferable transit corridor for inter-continental north-south transit routes.

The challenge is that to the extent that Uzbekistan becomes a major transit route, its present restrictive trade regime would come under increasing threat. The combination of tariffs and import excis-

es raises the effective import tax level for some consumer goods in the Uzbek market to three digit levels. Such levels of taxation present extremely attractive arbitrage gains for traders. Increasing transit trade would therefore increase competition for these rents and undermine Uzbekistan's present economic policies. Although Uzbek consumers would welcome such a change, the political challenge it poses is significant and may explain why Uzbekistan has so far hesitated to embrace more fully the trade and transit opportunities of integration with the wider Central Asia region.

Short-term Policies

For Uzbekistan to move from the slow to the fast lane in regional cooperation and integration is perhaps first and foremost a question of leadership and political will. Still, a number of short-term measures may offer high returns and harbor relatively few political risks for the present leadership, including:

- Creation of border zone markets, which are accessible to residents from these zones and within which duty free trade is possible.
- Rebuilding Uzbekistan as a wholesale trade center for Central Asia starting from a pilot project that allows competitive access of import wholesaling operations to one wholesale market in Uzbekistan. As a side benefit, this could help reduce production costs of Uzbek firms because of easier and more reliable access to imports.
- Concentrate donor support for trade and transit along a few selected transit routes. This may reduce Uzbek security concerns about allowing greater movement of goods and people across the "friendship bridge" with Afghanistan. The support could further extend to the roads and rail links along inter-continental corridors, so that transport investments and trade facilitation measures, as well as border security initiatives are fully coordinated.
- Technical assistance to help Uzbek suppliers compete in Afghan rebuilding efforts. This is an area where both Afghanistan and Uzbekistan could benefit from working together and build a basis for sustainable regional cooperation in the future.

As the international environment changes and the opportunity costs of standing still become ever greater, more ambitious measures may become feasible.

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Kazakh and Kyrgyz Firms Have It Easier To Do Business

Kazakhstan — the only Central Asian economy classified as a lower middle income country — has the highest rank in the region on the ease of doing business (63 out of 175 countries surveyed), and moreover, has improved its result from the previous year by jumping 19 places. Along with Armenia and Georgia it is one of the three top-ranked countries in the region (and 33 places ahead of Russia). The World Bank's "Doing Business" report particularly notes Kazakhstan's reform in the area of getting credit. The country's first credit bureau began distributing credit reports on potential borrowers. The new bureau currently covers 5.5% of Kazakh adults, using information from 29 commercial banks and collecting both negative data (on loan defaults, for example) and positive data (such as on-time payments).

The Kyrgyz Republic has also improved its performance compared to 2006, in particular, in the areas of getting credit and registering property. It introduced a flat notary fee for land transfer agreements, replacing the percentage fee. This decreased the cost to transfer title from 5.25% to 1.99% of the property value. The Kyrgyz Republic also permitted the enforcement of collateral agreements outside of court, speeding lenders' ability to collect on bad debts. And it reduced the mandatory notice period for dismissing a redundant worker from two months to one month.

Tajikistan (133) and Uzbekistan (147) rank lowest in the region, and Tajikistan went backward three places in 2007compared to the previous year. Also Uzbekistan made it more difficult to do business. It introduced a new tax on business-a mandatory contribution to the School Education Development Fund-increasing the total tax burden from 106.3% to 122.3% of profits. It also downgraded secured creditors' rights in bankruptcy.

The rankings track indicators of the time and cost to meet government requirements in business start-up, operation, trade, taxation, and closure. They do not track variables such as macroeconomic policy, quality of infrastructure, currency volatility, investor perceptions, or crime rates.

The report finds that particular remaining obstacles in the region are slow and bureaucratic trade regimes and high and complex tax systems. For example, in Kazakhstan, exporting a good takes 93 days and requires 14 documents.

Easiness of Doing Business in Central Asian Countries

	Number of tax payments per year	Time to pay taxes (hours per year)	Total tax rate (% of profit)	Time to import (days)	Time to export (days)
Kazakhstan	34	156	45	87	93
Kyrgyz Republic	89	204	67.4	127	n/a
Tajikistan	55	224	87	44	72
Uzbekistan	130	152	122.3	139	44
Average in Europe and Central Asia	50	423	56	37.1	29.2

Source: World Bank, "Doing Business in 2007: How to Reform", www.doingbusiness.org

Source: World Bank, "Doing Business in 2007: How to reform", www.doingbusiness.org **BT**

The Effect of Armed Conflict on Schooling in Tajikistan

School enrollment in conflict-affected areas was still lower several years after the end of the war

Olga Shemyakina

In Tajikistan, old grievances and new challenges to the existing authorities led to a violent civil war that started in early 1992 and was followed by a prolonged armed conflict. In 1997, the UN facilitated a peace accord between Tajikistan's government and the opposition. However, the transition to peace was often disrupted by violence. The conflict ended in November 1998 when government troops forced the remnants of the opposition groups out of Tajikistan.

The human cost of the conflict was substantial for the 6.4 million inhabitants of Tajikistan. The conflict displaced at least 600,000 people internally, forced 500,000 to leave the country for good, claimed the lives of at least 50,000 men, and orphaned 55,000 children, according to estimates made by the Asian Development Bank.

In theory, armed conflicts can affect education by reducing expected returns on schooling thereby motivating decisions to stop attending school; by decreasing households' resources; by restricting access to schooling; and by destroying infrastructure, including roads and schools. Further, civilians are often targeted by warring parties for hatred or retribution. Thus, households may experience a lack of physical security and keep their children away from public places.

The individual and household level data from the 1999 and 2003 Tajik Living Standards Measurement Surveys allow comparison of households which were significantly exposed to conflict with those that did not suffer as much, and to assess the effect of the armed conflict in Tajikistan. The past damage to a family's home, other dwellings in a community and residence in a high conflict intensity area are used to proxy for a given household's exposure to economic and social hardships as a result of war.

Strong Educational System

Like other FSU countries, Tajikistan mandates nine required grades of schooling for children of ages 7 to 15. The government is responsible for providing the general education in the state educational institutions free of charge.

Despite the strong educational system and the popular support for education, enrollment rates in Tajikistan started to decline soon after it's independence in 1991, according to UNICEF. The initial decline in enrollments in the academic years 1991-1992 and 1992-1993 coincided with the first and most brutal years of the Tajik civil war. The enrollment rates at all levels of education began to recover in 1997-1998, soon after the peace agreement was signed.

Short–Term Effects Biggest for Girls

The empirical results suggest that the damage to the household's dwelling during the past civil unrest was strongly negatively associated with girls' school enrollment in 1999. In particular, girls ages 12-15 were 13% less likely to be enrolled if their household's home was damaged as compared to girls of the same age from the households that did not report such damage.

Remarkably, no such effect was observed for boys of school age. This may imply that households affected by the conflict played "safe" and invested more in schooling boys. It is also possible that the expected return on investment in education of girls was lower in areas affected by conflict as many enterprises that traditionally employed women closed their facilities during the conflict. Further, families may have viewed older girls as more vulnerable to risks associated with conflict activity (such as rape and harassment), and therefore kept them at home.

Enrollment rates among younger children aged 8-12 remained high, implying that households attempted to protect the education of younger children by allowing them to complete at least primary school.

Not surprisingly, educational attainment by parents and household per capita expenditure are positively associated with child enrollment. A mother's widow status in households affected by conflict had a large negative impact on girls' enrollment, possibly indicating lower access to resources by widows in such households.

Children who were of school age during the war were significantly less likely to complete their mandatory education by age 17 than those who had an opportunity to complete their education before the start of the conflict. The probability of completing nine grades is 4% and 7% lower for boys and girls respectively. Further, the probability decreases by another 5% for girls, born in 1978-1986, who also lived in regions affected by the conflict during their schooling years.

Despite the rise of the enrollment rates after the end of the war, the rates in the conflict affected areas were still below those in areas not affected by the conflict.

What Can be Done?

To increase school enrollment and keep children in school until graduation, the Tajik government should address the distress that society may still be experiencing after the conflict and the subsequent decline in livelihoods. To attract children to schools, the government may offer free hot meals to students. To keep students in school, it is advisable to improve the quality of education and the quality of physical facilities, sanitation and safety. Furthermore, it may be advisable to create girls' only classes at the higher levels of education, making school attendance by older girls more acceptable in some conservative communities.

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Remittances in Tajikistan

In 2004, remittances could amount to up to 28% of GDP, according to some estimates

Jariya Hoffman

Since gaining independence in 1991, Tajikistan has experienced high levels of out migration. Early emigration was motivated by the civil war, while more recent migration has been provoked by economic factors, such as an increase in the demand for labor in Russia, strong economic growth combined with slow job growth and the low wage level in Tajikistan. Economic growth averaged 9.6% in 2000-2004, yet Tajikistan remains the poorest economy in Central Asia with a per capita GDP of US$310.

Who are Tajik Migrants?

A migration survey conducted in May 2005, shows that the average migrant is a 34 year old married male with five dependents. The majority of migrants have secondary education or vocational training. Most are unemployed or grapple with a low wage level that is insufficient to meet basic household needs. They spend on average 14 months in Russia (and in other host countries) and mostly work in construction, services, and manufacturing. Given the dearth of migration statistics, the true number of Tajiks living outside the country is unknown and a large number of them are undocumented migrants. One official estimate suggests the number was about 421,000 in 2004, while other estimates indicate numbers of up to 1.2 million Tajiks living overseas.

What is all the more remarkable about Tajik migrants is that they are the source of a large volume of funds that are being sent back home in amounts so significant that they have now become an important source of economic growth for Tajikistan. In fact, the level of remittances ranks second after aluminum and ahead of cotton if considered as an export of labor services in 2004, and towers over those of official development assistance and foreign direct investment. Between 2000 and 2004, official estimated remittances increased from 0.1% to 12% of GDP. Alternative methods of estimating remittances produce numbers of up to 21-28% of GDP.

Financial Snapshot of a Tajik Migrant
(Average monthly income, excluding unemployed)

Pre-migration	$30
During migration	$274
Post-migration	$91
Saving/Income	0.015
Remittances/Income	0.476

Source: Tajikistan's Sociological Research Center Zerkalo

Remittances have become a source of income for many low income families to meet basic needs. The migration survey suggests that the financial situation of migrants and their families improve after migration. Their income overseas is ten times what they earned in Tajikistan before migration (see table), of which about 48% is remitted to Tajikistan. Remittances are used for consumption, home repair, education and health, and savings. Consequently, they have contributed to short-term economic growth and poverty alleviation through increased domestic demand. At present, their contribution to longer term growth through investments in productive activities is limited by the low level of migrants' income and an unfavorable business environment. However, their contribution to funding the education and health needs of families is arguably an investment in human capital that can yield benefits both in the near and medium-term.

Policy Recommendations

Yet, as international research shows, large inflows of remittances can lead to a real appreciation of the exchange rate, increase the vulnerability of recipient countries to host countries' migration policies and business cycles. To mitigate the potential negative impacts and to enhance their longer term positive impact, the government of Tajikistan is seeking appropriate policies on how to further enhance the use of remittances beyond increasing the standards of living and welfare of household recipients. We propose that the Tajik authorities encourage a pro-business environment, which requires maintaining a stable macroeconomy and simplifying licensing and inspection regimes, and enhance the role of financial intermediaries for mobilizing savings and investment resulting from remittances. Such policies include:

- Encourage entry of foreign banks into Tajikistan to foster modernization and to further increase public trust in the banking system;
- Cross-selling of financial products by commercial banks to migrants as incentives for keeping their savings in the banking system;
- Promote healthy competition of commercial banks to further reduce transfer fees;
- Improve public information dissemination related to financial services by both the state and commercial banks;
- Integrate micro-financial institutions into remittance services to mobilize un-banked remittance savings from migrants in rural areas and channel them towards productive investment including small business and agricultural projects.
- In the near-term, improve the quality and coverage of statistics on migration and remittances, including estimating informal transfers of remittances in the balance of payments and improving household budget surveys.

In terms of policies designed to increase remittance inflows that are not fully under the control of the Tajik authorities, the latter should more proactively engage in bilateral diplomatic negotiations with Russia to remove obstacles to migration with the aim to:

- Protect the rights of undocumented Tajik migrants in Russia;
- Simplify the registration process of resident permits for Tajik migrants;
- Lower the cost to Russian employers when hiring foreign workers.

This Policy Note is part of the 2006 Country Economic Memorandum for Tajikistan prepared by a team of experts from ECSPE, the World Bank, Washington DC. Full text of the paper is available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/08/22/000160016_20060822094201/Rendered/PDF/357710TJ.pdf **BT**

Dimensions of Urban Poverty in Central Asia

The urban poor are overwhelmingly located in secondary cities

Ellen Hamilton, Christine Kessides, Deniz Baharoglu, Bill Denning, Alexandre Kolev, Maka Lomaia

Compared to other transition countries, Central Asia is much less urbanized: the average share of the urban population in the region is only 40%, which can be compared to the average of 63% for all transition countries in Europe and Central Asia (see Table 1). The concentration of the urban population in the largest city is, however, significantly higher than in transition countries (on average, 15%), with the exception of Kazakhstan.

Our study explores the extent and nature of poverty in urban areas, providing particular attention to how urban poverty varies across urban areas (the capital and secondary cities). We also focus on dimensions of poverty related to provision of network infrastructure and energy services in cities. We rely on data from household surveys for 20 transition countries, including the five Central Asian countries.

Households in Secondary Cities Worse Off

In Central Asian countries, secondary cities are home to the majority of all urban residents, as is true in other transition countries. We find that on average the poverty risk for residents in secondary cities is two to four times greater than for residents in the capital. That urban poor are overwhelmingly located in secondary cities in almost all transition countries reflects the relatively weak conditions of employment, limited economic diversification and fewer economic opportunities in secondary cities.

Also in Central Asian countries the incidence of poverty in secondary cities is much higher than in the capital (see Table 2). It is striking that in Tajikistan poverty in secondary cities exceeds that in rural areas.

Household heads in secondary cities in Kazakhstan, Kyrgyz Republic and Turkmenistan are more likely to be unemployed than those in the capital or rural areas (this finding is also true for the majority of transition countries), while in Tajikistan and Uzbekistan unemployed heads predominate in rural areas. Across all transition countries, the relative poverty rates among the unemployed household heads in the secondary cities is only slightly below that of rural areas, but half as large as that of the capital cities. This suggests that the unemployed in secondary cities stay unemployed longer and cannot rely on financial safety nets to the same extent as in the capital cities.

Less educated household heads and large families are consistently associated with poverty. The high rate of poverty for the former reflects both a lack of access to supplemental income from farm production as well as less ability to compete for well-paying urban employment. In the case of large families, the high rate of poverty reflects the need for urban families to have cash for essential goods and services.

Table 1. Urbanization Rates in Central Asia, 2001

	Urban population (% of total)	Population in the largest city (% of urban population)
Kazakhstan	56	13
Kyrgyz Republic	34	43
Tajikistan	28	30
Turkmentistan	45	23
Uzbekistan	37	24
Low-income countries	31	17

Source: World Development Indicators 2003

Reliability of Basic Services a Serious Challenge

In our study we view both income and non-income dimensions of poverty, the latter including access to housing, infrastructure, and energy services. Although formal access to infrastructure and energy remains higher in urban than in rural areas, many households face unreliable and deteriorated services. Indeed, our findings show that despite high connection rates, the reliability of basic services is a serious challenge in the region. For example, only two out of five households with water connection in the capitals of Tajikistan and Turkmenistan have 24-hour access to water. The gap between connection and reliability is particularly pronounced in secondary cities. For instance, while almost all households have access to electricity 24 hours a day in the Kyrgyz capital, only 49% of households in the Kyrgyz secondary cities have such access.

Environmental and sanitary conditions are poor for many urban households. Across all transition countries, more than 40% of urban households report burning, burying or dumping household waste. Households in secondary cities are also much less likely to have access to adequate sanitation (i.e., an inside toilet) and much more likely to use dirty fuels than are capital city residents, both of which are indicators of poor living conditions.

Highest Inequality Found in Secondary Cities

Although one might expect to find the highest inequality within the capital city, which is typically the center of the greatest wealth, in Kazakhstan and Turkmenistan the secondary cities are the most unequal (as measured by the Gini coefficient), albeit by a small margin.

In terms of infrastructure provision, in capital cities households in the bottom quintile are less likely to be connected to

Table 2. Poverty Incidence (Headcount) by Settlement Area

	Capital city	Other urban	Rural
Kazakhstan	4.41	16.31	26.18
Kyrgyz Republic	7.03	19.71	23.23
Tajikistan	5.05	21.65	20.92
Turkmenistan	n/a	12.45	27.95
Uzbekistan	5.59	18.63	22.64

Note: the table portrays relative poverty, i.e. the share of each settlement area's population falling below the lowest quintile of national income.

district heating, running water and phone lines than higher income households. The differences between connection rates for low and high income households are again greater in secondary cities than in the capitals. A similar picture emerges for per capita housing space. Although the transition countries are generally well provided with housing space on a per-capita basis, lower income households have substantially less space than do high income people. The disparity in housing provision for rich and the poor is greater in secondary cities than in the capitals.

Issues for Policy Makers

- *Secondary cities*. The urban poor are overwhelmingly located in secondary cities; however, little attention has been paid to these so far because most poverty analyses fail to differentiate among urban settlement types. As a result, the better off capital cities conceal the degree of poverty in the secondary cities.
- *Emerging slums*. Development of real estate markets in transition countries has provided a mechanism for increasing the spatial concentration of different groups — i.e. development of slums at peri-urban areas as well as in city housing stocks. At the same time, the erosion of public transportation and other public services has meant that marginal neighborhoods are less likely to be well connected to the city fabric and public services and residents are more likely to face exclusion. Preventing the emergence of slums among the existing housing stock is a problem that is perhaps unique to the region. Policies relating to provision of public services and transport, urban development, social assistance programs and the housing sector will all influence slum development.
- *Mobility*. The study finds that poor households are much less likely to have moved during the past five years than better off households, particularly in capital cities (for example, in Kazakhstan where the difference reaches 10 percentage points). If residential mobility is an adjustment mechanism to enable households to satisfy their housing needs and find jobs, as is true in other countries, then low income people in cities are trapped due to both housing sector conditions and tight labor markets.
- *Deteriorating services*. Infrastructure services continue to erode. The continued reliance on connection data, instead of reliability figures, serves to conceal the degree of erosion in infrastructure provision. As service quality deteriorates, the region faces a major challenge since the poor quality of services provides few incentives for payment. At the same time, housing expenditures remain below 10% in many transition countries. In Central Asia the share of housing expenditures is even lower at no more than 5% (except for Kazakhstan, where it reaches 12%). At the same time, the average for OECD countries is 20%. Low tariffs, widespread exemptions and non-payments explain the low rate of spending. Clearly, in this kind of environment, service providers are not able to invest in the rehabilitation of infrastructure facilities, perpetuating the vicious cycle of widening infrastructure poverty. This suggests the need to review carefully existing tariffs, payment practices and subsidy systems with the objective of improving quality and access for the poor.

The article is based on the 2006 report "Dimensions of Urban Poverty in Europe and Central Asia Region" prepared by the Infrastructure Department, Europe and Central Asia Region, World Bank, Washington, DC. The report covers 20 transition countries in Europe and Central Asia. Full text of the report is available at: http://siteresources.worldbank.org/INTECAREGTOPURBMUNGOV/Resources/urbanpoverty.pdf **BT**

Slums in the Peri–Urban Areas of Bishkek

Large internal migration flows in the Kyrgyz Republic in the past ten years have seen the emergence of new slums in the periphery of Bishkek. Today there are 23 precarious settlements in Bishkek, the largest has 4800 land parcels, while the smallest has about 100. Many internal migrants often lack the funds for the construction of real houses and therefore live in shoddy structures. Most of these settlements lack basic infrastructure services and are often located in areas where there are adverse environmental health-related impacts.

One of the most populated slums, the Ak-Bosogo settlement, has very serious problems with water supply. Another populated area, Bakai-Ata, is located close to the ash dump of the Bishkek power and heating station, which is the source of heavy pollution. Even a slight wind lifts ash into the air covering all houses and facilities in this residential area. Other settlements are located in the lower part of the city and are flooded after rains or melting snow, which regularly destroys the houses.

There are important differences across the settlements in terms of the demographic characteristics of the residents, which reflect the various regions from where people migrated. In the Salam-Alik settlement, children comprise only 10% of the total population. In the Kelechek settlement, for instance, the children make up 70% of the total population. Kelechek is mostly inhabited by migrants from the Batken region, which has the highest birth rate in the country.

Source: Rakisheva, K. 2002. "Impact of the Internal Migration Upon the Poverty Problem." Mimeo. As cited in World Bank (2003). Kyrgyz Republic: Enhancing Pro-poor Growth. **BT**

Evaluating Pension System Design in the Kyrgyz Republic

The attempt to "borrow" the pension system design from more developed countries and implant it in the transitional economy has not been successful

Roman Mogilevsky

Before 1991, the Kyrgyz Republic had the same pension system design as other Soviet Republics: a low pension age (60 for men and 55 for women), universality, relatively high replacement ratios (no less than 63%), and defined benefit and pay-as-you-go principles at the bottom.

In 1991, social security expenditures amounted to 6% of GDP, and the Republic was receiving substantial transfers from the Soviet government. Following the break-up of the Soviet Union, the country's GDP fell sharply — to 52% of the 1990 level, and the transfers from the center ceased. Agriculture and the informal trade and services sectors, which had the lowest effective pension fund contribution rates, increased as shares of GDP, while the shares of manufacturing, transportation, and communications, which contributed the most, shrank. As a result, despite a relatively low share of retirees of about 10% of the population, the pension system became too heavy a burden for the country.

Due to the shortage of pension fund resources, in 1994 the size of the average pension fell to only 70% of what it was in 1990. Pension arrears and payment of pensions in-kind became widespread.

Choosing a Model

The pension reform had to restore the fiscal sustainability of the pension system and protect the elderly from falling into poverty.

In choosing a model for pension reform the Kyrgyz government was severely constrained by an underdeveloped financial market and a lack of cash. This prevented it from introducing a fully-fledged contribution-funded system or developing voluntary pension insurance through private pension funds.

Following Italy and Latvia, the Kyrgyz Republic opted for the so-called notional defined contribution system (NDC). In this system, pension contributions are "accumulated" on a worker's virtual individual pension account but are not saved (unlike in the system above); instead, they are used to pay pensions to current retirees. The NDC system allows for much less redistribution and creates incentives for individuals to make contributions during working life.

The 1997 law introduced many significant changes to the pension system:

- A gradual increase in the retirement age from 60 to 63 for men and from 55 to 58 for women;
- Abolishment of many privileges, such as early retirement for some occupations and population groups;
- A three-component pension system: a base pension guaranteed to everyone with a sufficiently long working experience; a defined benefit pension calculated as a percentage of the average wage before 1996; and individual retirement contributions accumulated on individual accounts.

The average pension is now above the poverty line, and households with retirees bear 20% less risk of becoming poor

System Functioning Sub-optimally

The above measures helped to reduced pension liabilities. The pension fund expenditures decreased from 6.9% of GDP in 1996 to 4.9% in 2005. The average pension is now above the poverty line, and pension arrears have been eliminated. The pension system has also become much better at insuring the elderly against falling into extreme poverty: currently, households with retirees bear 20% less risk of becoming poor in comparison to households without retirees. Of course, general economic recovery has contributed much to these results.

Yet pensions remain low, with an average pension just slightly above US$20 per month in 2005. The replacement rate is half of what it was before independence. The performance of the NDC component is especially troubling. Nine years on, the informal sector employees and labor migrants in other countries are still not registered in the system. Due to widespread tax evasion, a lot of workers, especially in the informal sector, have accumulated little on pension accounts, while the pension fund has struggled with perennial deficits, which have been covered by government budget transfers. The law also failed to introduce an inflation indexation mechanism for the second and third components, which undermined the workers' incentives to contribute.

Fiscal Sustainability Not Attained

Thus, the fiscal sustainability of the system — one of the main objectives of the reform — has not been attained. Inconsistent government policy has certainly played a role, as the government has insisted on preserving a big variation in payroll tax rates for different groups: formal sector employees have to pay 27% tax (until recently 32%), while agriculture and trade workers — two-thirds of the total employment — only 1-2%. Many politicians still see a waiver of pension fund contributions as an easy way to provide support to their constituencies.

Unfortunately, hopes of the Kyrgyz Republic's relatively quick transition to an industrialized economy appear to have been too optimistic. The current economic structure, characterized by

semi-subsistence agriculture and a large informal sector, mass labor emigration and consumption increasingly dependent on remittances from abroad, impede the smooth functioning of the NDC pension system. So, the attempt to borrow the system design from developed countries and implant it in the transitional economy of the Kyrgyz Republic cannot be deemed a success. This is despite the fact that some reform components aimed at reducing pension liabilities have been quite successful.

The question of what pension system design can be suitable for a country like the Kyrgyz Republic remains open. Perhaps one should explicitly account for the deeply-rooted tradition of providing support to the elderly by younger family members. Such family insurance mechanisms complemented by a simple pension system, which provides minimal social protection could perhaps be a more feasible solution for a country without the clear prospect of turning into an industrialized economy.

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Past Reforms and Future Challenges in the Kyrgyz Republic

In the past years the Kyrgyz Republic has put in place the building blocks of a market economy and progressed on the way to achieving macroeconomic stabilization. In 2003-2004, the average real GDP growth rate was about 7% per year, and growth took place in all sectors. Inflation has been low at below 5% in recent years, the exchange rate has been stable, and the government budget deficit has been reduced to below 5% of GDP. According to the EBRD Transition Index, the Kyrgyz Republic's indicators are above the average level in the CIS in all areas except for infrastructure reform.

Agriculture remains the largest sector producing roughly one-third of the country's GDP. Land reform has substantially progressed; a new agrarian structure has emerged with universal access for farmers to land, the prevalence of small farms, and gradually growing farm productivity. However, farmers' access to input and output markets is still limited, and disinvestment (fixed capital depreciation exceeding new investments) poses a major threat in the long-term. Another important and dynamic sector of the economy is SMEs in light and food industries and the services sector. These account for a vast share of urban employment; however, since many of them operate in the shadow economy, they face limited development opportunities.

Kyrgyzstan has been the largest recipient of foreign aid in absolute and per capita terms in Central Asia. The per capita official development assistance amounts to almost US $460 (the figure for second biggest aid-receiver, Tajikistan, is US $185). The aid mainly helped to balance the budget and provide support to health care, education, agriculture, financial sector, small and medium enterprise development, institution building and infrastructure maintenance and development.

Economic growth has helped to reduce the share of the poor from 55% in 1999 to 41% in 2003. Key social indicators, such as infant mortality, life expectancy at birth, basic secondary education enrollment ratio, etc. have remained quite stable. However, insufficient public funding of the social sector has led to a steady decline in the quality of services. In health and education the private sector is becoming increasingly active and is expected to partially substitute public organizations.

Despite an impressive reform record the Kyrgyz Republic faces some serious challenges. On the economic side, the country urgently needs to diversify the sources of economic growth away from agriculture and SMEs working in the shadow economy. This entails a significant increase in investments (both in physical and human capital) and exports. This should be coupled with massive public investments in infrastructure. A large foreign debt of US$2 billion, which has reached unsustainable levels, remains a significant problem that needs to be urgently addressed.

In the social sector, the key challenge is how to restructure extensive education and health care systems inherited from Soviet times, without compromising access for the poor and the quality of services. Governance issues, such as inefficient public institutions, rent-seeking, unclear and changing legislation, also need to be addressed urgently.

To achieve sustainable economic growth and enhance export potential, the Kyrgyz Republic needs a large inflow of investments. Recently domestic savings increased from almost zero in the end of 1990s to 12-13% of GDP in 2002-2003; yet these resources are not enough to make up for a huge disinvestment, which took place during the 1990s. The potential sources of FDI are the developed countries of Europe and North America, Japan, as well as China, Russia, Turkey and the neighboring Kazakhstan. The active measures taken by the government to achieve macroeconomic stabilization and reduce poverty have born some fruit, and the FDI inflow increased from US $90 mln in 2001 to US $147 mln in 2003. Much more work remains to be done, especially in reducing the regulatory burden and fighting corruption.

Source: "Kyrgyz Republic and the Problems of Regional Cooperation in Central Asia" commissioned by the UNDP Regional Bureau for Europe and the CIS and prepared by the Center for Social and Economic Research CASE-Kyrgyzstan. The full text of the report has been published in the journal "Problems of Economic Transition", Vol. 48, No. 8 (2005) and is available at www.case.elcat.kg. **BT**

Kazakhstan Expenditure on Public Health

Decreased public health indicators, limited funding and ineffective spending mar public health system

Meruert Makhmoutova

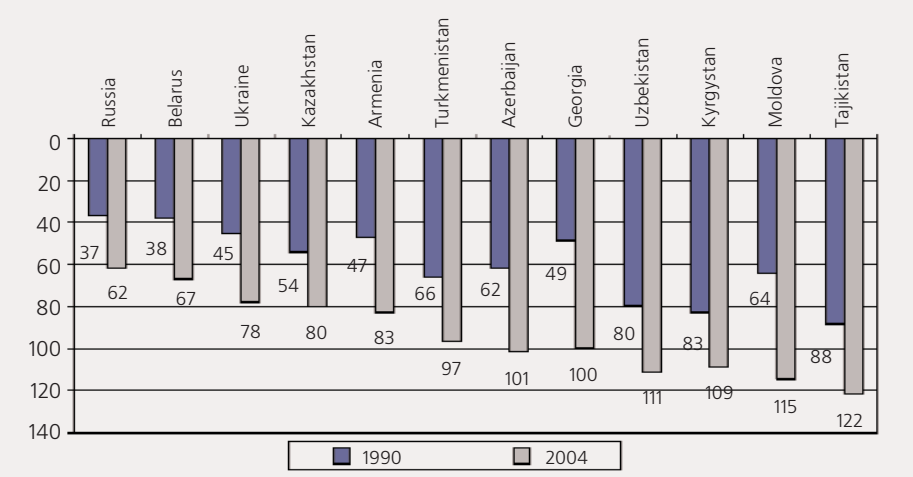
Government budget social spending determines the human capital development level, which in turn is a key condition of a country's sustained development. In terms of the UN Human Development Index (HDI), Kazakhstan ranked 79th in the world in 2004. HDI is calculated on the basis of life expectancy, literacy level and per capita GDP. All these indicators were declining during the 1990s, and by 1995 Kazakhstan had dropped to 93rd place among 177 countries. Although in recent years it has registered an annual growth rate of nearly 10%, it was not until 2004 that Kazakhstan managed to go back to its 1990 level in terms of per capita GDP and the share of people between five and 24 in education. The only indicator on which the country still lags significantly behind the 1990 level is the average life expectancy.

Health Indicators Low

The economic and political changes of the last 15 years have had a negative impact on health indicators, which have been steadily declining.

- According to the World Health Organization (WHO), Kazakh citizens born in 2003 can expect to live an average 61 years (females 67 years, males 56 years). On this count, Kazakhstan ranks below not only developed countries (77.6 years in the OECD countries), but also developing countries (64.9 years).
- The overall mortality rate has increased by 20% since 1990. The main causes of high mortality are cardio-vascular diseases, cancer, poisoning and injuries.
- According to the WHO, infant and maternal mortality in Kazakhstan is among the highest among European and Central Asian countries. Undoubtedly, the poor health of women — only 20-30% of them have a clean bill of health — is an important factor. Mortality rates vary between regions, with the highest infant and mother mortality registered in the Kyzylorda oblast in the south of Kazakhstan where these indicators are above average by 1.6 and 2 times respectively. The oblast is located in the Aral Sea area, where environmental problems brought about a catastrophic decline in the health of the population.
- The overall morbidity rate in 2005 had more than doubled since 1999 to 100,163 instances per 100,000 people.
- Kazakhstan ranks first in Europe in terms of tuberculosis incidence. According to national statistics, in 2005 there were 147.3 first-time diagnosed patients per 100,000 people, with the highest level again registered in the Kyzylorda oblast.
- As of January 1, 2006 Kazakhstan had 4,531 officially registered people living with HIV. In 2006 there was a flare-up of HIV in South Kazakhstan oblast: 82 children and 11 mothers were infected in the hospitals in the city of Shymkent during blood transfusion.

Kazakhstan's HDI Slides in 2004 Compared to 1990



Source: UNDP World Human Development Report, 1990 and 2004

Limited Funding Remains a Serious Problem

In spite of the unsatisfactory state of public health, the number of medical facilities dropped from 1788 in 1990 to 1063 in 2005, and government spending dropped from 3.6% of GDP in 1991 to 2.3% in 2006. While its GDP per capita puts Kazakhstan in the group of medium-income countries, in terms of public health spending it is among the poor countries. In comparison, public health spending in Belarus amounted to 4.9% of GDP and in Russia to 3.3% in 2003-2004. The government plans to reach the 4% of GDP target, which is the minimum level recommended by the WHO, only by 2010.

The reform of the health service in the 1990s resulted in mixed public-private financing and the appearance of non-government medical facilities and private clinics. But the attempt to introduce mandatory medical insurance for citizens was later abandoned.

Much of the public healthcare financing comes from local (oblast) budgets, which stand for 83% of the total financing. Local budgets finance the guaranteed minimum of free medical care, and the list of free services is approved by the government every year. Although the share of public health expenditure in GDP has fallen, its share in local budgets grew from 16.8% in 1999 to 19.2% in 2005. Spending on free medical care also grew in absolute terms to US$56 per person in 2005,

although regional variations were substantial: from US$104 in the Mangistauskaya oblast near the Caspian Sea to US$51 in the Almaty oblast.

Accordingly, there remain significant regional differences in access to heath care, which are being eliminated thanks to higher local budget revenues and targeted transfers from the national budget. While in 2001 the highest per capita healthcare expenditure was 4.7 times the lowest, by 2005 this gap had narrowed to 1.8 times the lowest.

Medical services outside the guaranteed free minimum are paid for by the households, employers, the voluntary medical insurance system. According to the Asian Development Bank (ADB), 91% of medical care was financed by the state, 7% by households and 2% by employers in 2002. Our calculations are close to those of ADB: in 2004-2005 households paid for 8% and 6% of healthcare, respectively.

The problem with assessing the size of the non-government sector of public health is that in the process of creating paid-for health care, public hospitals and clinics were transformed into municipal entities. On the one hand, they get state funding, but they also charge patients for their services. An average person coming to a healthcare facility does not understand which services are free and which have to be paid for.

Mother and Child Health Protection Measures

It can be thus concluded that the measures for combating diseases and protecting mother and child, including the Healthcare Reform Program, have not yielded the desired results. Shrinking public financing and the emergence of poverty have resulted in unequal access to medical care. There are still gaps in the cost of these services between regions, which makes it unlikely that Kazakhstan will achieve the Millennium Development Goals of reducing infant and maternal mortality rates by 2015.

In our opinion, the government is giving unwarranted priority to "pilot projects", such as the creation of a state-of-the-art "medical cluster" in Astana, in which leading foreign institutions are involved. This merely increases government spending on healthcare but makes little difference to the heath of mothers and children nationwide. It is necessary to revise budget spending priorities to make medical care more accessible to citizens living in remote areas, for example, in the Kyzylorda oblast which has the highest infant and maternal mortality rate in the country.

To bring down infant, child and maternal mortality rates and make spending on public health more effective the following measures need to be taken:

1. Provision of equal access to primary medical care and guaranteed levels of free services.
2. Development of medical and economic standards for each group of diseases whose treatment can be financed by the state. Introduction of diagnosis and treatment standards.
3. Separation between the public and private health care systems.

Tighter Spending Control

Even the admittedly insufficient amounts allocated to public health are not fully or effectively used. In the 15 months of 2005-2006 the Prosecutor General's Office uncovered 18,000 violations of citizens' rights in all the regions. These include failure to provide the guaranteed range of free services, illegal charging by public medical institutions for emergency medical assistance, incompetence of medical personnel as well as deaths through negligence of the medical personnel and untimely delivery of medical assistance. Added to these are ineffective or unjustified use of regional budget funds, such as overstatements of the cost of work and construction materials in the building of new hospitals, inferior quality of construction and installation of dated medical equipment.

The reasons for this are many: untimely adoption of regulatory acts on budget programs during the year, untimely state procurement, corruption, etc. All this makes it imperative that the increase of state financing of public health to 4% of GDP be accompanied by tougher control of how the money is spent.

Meruert Makhmoutova is Director of the Public Policy Research Center. The article is based on the author's 2007 study "Kazakhstan National Budget Spending on Education, Health and Social Protection in the Interests of Family and Child" conducted for UNICEF. The full text of the work will be published by UNICEF in spring 2007. Questions may be addressed to the author: sipa@nursat.kz. **BT**

Human Development Index for Central Asian Countries, 2004

HDI rank	Country	Human Development Index (HDI) value	Life expectancy at birth (years)	Adult literacy rate (% ages 15 and older)	Combined gross enrolment ratio for primary, secondary and tertiary schools (%)	GDP per capita (PPP US$)
79	Kazakhstan	0.774	63.4	99.5	91	7.440
105	Turkmenistan	0.724	62.5	98.8	...	4.584
110	Kyrgyzstan	0.705	67.1	98.7	78	1.935
113	Uzbekistan	0.696	66.6	...	74	1.869
122	Tajikistan	0.652	63.7	99.5	71	1.202

Source: Human Development Report 2006, www.hdr.undp.org

Promoting Innovation through Technoparks in Kazakhstan

Technoparks have been operating as business incubators rather than high-tech innovation centers

Slavo Radosevic and Marat Myrzakhmet

Kazakhstan — a fast growing transition economy — has been searching for ways to improve its competitiveness and diversify the economy away from heavy reliance on oil and minerals. The introduction of technology parks has been seen as a way to promote innovation, especially in hi-tech areas, and ensure growth based on local knowledge and innovation.

Technoparks are believed to promote economic growth and generate value by enhancing the ability of its tenants — high technology firms — to survive and grow in a very competitive environment. Nevertheless, there is conflicting evidence regarding the actual effectiveness of technoparks, in part, due to their wide variety, and also due to methodological difficulties in evaluating the contribution of technoparks to the local economy.

Kazakhstan differs from developed countries in that most of its R&D activities are carried out by public organizations rather than businesses (see Table). No noticeable shift towards firm-based R&D occurred during the 1990s.

Technoparks Firms Smaller, Younger, More Cash–Starved

Seven technoparks have been established in Kazakhstan's biggest cities through the initiative of entrepreneurs in public administrations, primarily at the local level. We have surveyed 21 entrepreneurs and administrators from five major technoparks and collected data on a reference group of 24 firms located outside the technoparks.

The survey shows that Kazakh technoparks are quite young and small, housing between 16 and 46 enterprises. Technoparks tenants are much smaller than firms outside technoparks, with median employment per firm equal to 9 and 32 people, respectively. Technoparks tenants are also younger than other firms (with median age of four vs. nine years old, respectively). Service-providers account for 45% of the firms inside technoparks, while their peers outside of technoparks mainly engage in manufacturing. This partly explains the difference in the average size of the two types.

In contrast to other countries, where technoparks mainly house high-tech companies, many firms in Kazakh technoparks work in traditional industries, such as furniture and souvenir production, trading, etc. In fact, the provision of traditional products and services dominate. Only four out of 110 firms claim they engage in IT services, and 11 engage in pharmaceuticals development. Nor is there any traceable difference in the proportion of innovative firms (developing a new product or process which is either new to the firm or to the market) operating inside and outside technoparks. Another surprising result is that technopark firms largely work in local markets, with about 90% of sales having local destinations.

Why Relocate?

Our survey shows that lower rents and the better image that operating in a technopark gives rank highest among reasons to relocate to a technopark (relevant to 50% and 79% firms, respectively). That these firms see lower rents as an important benefit is not surprising given the young age and possible cash flow problems of the firms. Although most firms do not expect that location in a technopark will significantly improve their access to finance, they expect better-quality business services and infrastructure. Location in a technopark, however, does not seem to fully realize their expectations: infrastructure was considered a key barrier to growth for 38% of firms.

Do technopark firms have stronger linkages with other tenants and universities? In fact, the answer is no on both questions. The greatest intensity of linkages is with outside firms.

Thus, it is obvious that Kazakh technoparks do not really act as vehicles for the commercialization of new technologies. Instead of serving the centers of innovation promotion and economic diversification, they actually operate as business incubators for small local firms operating in traditional sectors.

R&D in Kazakhstan, the EU and North America

Proportion of gross expenditure on R&D performed by:	Kazakhstan, 2002	North America, 1995	EU, 1995
Businesses	18.6	**59.3**	**52.5**
Higher Education sector	22.2	15.6	20.8
Government sector	**57.2**	10.2	16.2

Sources: OECD, 2000, and Statistical Office of Kazakhstan

Policy Conclusions

Kazakhstan's transition from a public-driven R&D to firm-based innovations cannot be successfully implemented within the current policy framework. Such policy directs the bulk of funding to investments in infrastructure and buildings, with little attention given to identifying innovative projects, and creating links between industries and research institutions/universities. Policy should instead prioritize support to innovative research, as well as investments in human capital and new skills. As the domestic demand for research is still small, innovation policy should assist companies in upgrading their technological capabilities to a level at which they can articulate their demand for R&D.

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Corporate Philanthropy in Transition

Slovakia lags behind the Czech Republic in giving

Katarina Svitkova

The study examines corporate charitable giving in the Czech Republic and Slovakia, analyzing unique datasets collected through face-to-face interviews with 739 Czech and 152 Slovak firms, conducted in 2004-2006 by market survey company Median.

There are several reasons why corporate charity in transition countries could differ from that in developed economies: Transition economies continue to lag behind the developed countries in economic performance, an important determinant of corporate charity. They also lack a tradition of philanthropy and corporate social responsibility. The widespread perception of nonprofit organizations as inefficient and unprofessional, to some extent explained by their short history, hinders cooperation between the corporate sector and nonprofits. Such cooperation is however being strengthened by the EU accession and various European regional programs. In addition, both the Czech and the Slovak Republics experienced significant economic growth during 2001-2005, which may consequently intensify philanthropic activities.

In the study we distinguish between sponsoring and giving, which are subject to two different tax treatments. This would suggest that corporations use these tools differently, to achieve different objectives. This hypothesis however has not been empirically tested yet.

Sponsoring is entered in the accounts as costs, and the contract requires the receiving party to provide some services in return for funding. The corporate tax rate is therefore the only legal factor that influences the expenditures on sponsoring.

The giving contract, on the other hand, requires nothing in return. Outgoings on giving represent after-tax expenditures, tax deductible up to 5-10% of the tax base in the Czech Republic. Until 2004, donations were tax-deductible up to 2% in Slovakia, since 2004 donations are not tax-deductible.

In general, the legislation governing corporate philanthropy was very similar in the Czech and Slovak Republics until 2004 when several major changes were introduced in Slovakia. Among other things, Slovakia lowered the corporate tax rate from 25% to 19% and introduced tax assignation, which allows corporations and individuals to assign a fraction of their taxes to a particular charitable purpose.

Scope, Location Important

In both countries the size of the company, as measured by the number of employees and sales, increases engagement in both sponsoring and giving. The number of employees increases giving more than sponsoring, while sales have a similar effect on both. In terms of philanthropic expenditures, small firms in the Czech Republic are more generous givers than large firms, while the opposite is true in Slovakia. This may imply that philanthropic culture in Slovakia, particularly among small firms, is not as developed as in its neighbor.

The corporate tax rate plays no role in the decision to give or the amount spent

We expected the highest engagement in philanthropy from the service sector firms. Yet this is only true for the Czech Republic (and only for sponsoring), while the most active sponsors and givers in Slovakia are found in retail. In terms of the amounts spent, the service sector firms are the leaders in giving. Service firms have lower profitability compared to firms in other sectors, which may explain their modest participation; but once they start to engage in philanthropy they tend to give more because of their close relationships with stakeholders.

In Slovakia, firms operating on international markets are much more active sponsors and givers, in contrast to the Czech Republic, where local and regional firms are more active givers. This again suggests that philanthropic culture in Slovakia is lagging behind, with philanthropy still being the domain of large and internationally-focused firms. Stakeholders in Slovakia seem to be less powerful and unable to induce participation of firms at the local level.

If a firm is located in the capital city, it engages much less in philanthropy compared to regional firms. This could be explained by the free riding effect and the anonymity of large cities, which makes it more difficult to establish partnerships. However, while firms in Prague are not frequently engaged in philanthropy, they spend more on giving than firms in other regions, perhaps because they are more profitable than other firms.

Impact of Taxes Small

One of the major questions of our study was whether decreasing corporate tax rates affected corporate philanthropy. Contrary to our expectations, the tax rate plays no role in the decision to give or sponsor or the amounts spent.

We also observed that only approximately half of Slovak firms participate in assignation, a very low number if we take into account that assignations impose only administratively negligible costs on the company. This may be caused by low (or negative) profits, and/or a lack of interest.

Thus, the results of our analysis reveal that despite the long common history of the two countries there are significant differences in the philanthropic behavior of firms; the difference being significant only in giving, sponsoring behavior remains very similar. Firms in the Czech Republic give more often and in larger amounts than their Slovak peers. In addition, giving in Slovakia is more prevalent among large firms operating at the international level, while in the Czech Republic smaller, regional firms also participate. These differences seem to be caused by the differences in profitability, further enforced by missing "leaders" among large firms in Slovakia.

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Enhancing South–South Trade in Goods

57% of the global gains from tariff removal accrue to countries in the South

Przemyslaw Kowalski and Ben Shepherd

Furthering trade integration between low and middle-income countries (with per capita GNI below US$9,075 in 2003) can contribute substantially to these counties' development and welfare. These countries, referred to as the South, currently face relatively high trade barriers. South-South trade can be viewed as both an alternative and a complement to trade with more technologically advanced developed countries in the North. It would entail smaller relative price changes and thus less severe structural adjustment, open up possibilities for learning by doing, and allow Southern countries to break into the North's markets for more technologically advanced products. The relatively higher growth rates in developing countries add to the potential of South-South trade.

Impressive Growth During the 1990s

Since the early 1990s, South-South trade has expanded at a more rapid rate than either North-North or North-South trade, though starting from a much lower base. South-South trade grew on average at 12.5% a year, compared with 9.75% for North-South trade. In 1985 it made up around 3% of world trade while in 2002 this share has already been estimated at 6%.

For some commodities, such as beverages, tobacco, and chemicals this share has increased from around 2% in 1985 to around 6% in 1990, largely in line with total trade. In some sectors, such as food and live animals and animal and vegetable oils and fats, the share of South-South trade was already higher at the beginning and continued increasing. The lowest shares of South-South trade were observed in machinery and transport equipment and manufactured articles. In general, compared to other trade flows, South-South trade seems to be relatively more concentrated in less-processed products.

Finally, South-South trade is generally subject to much higher barriers than North-South or North-North trade. For example, the tariffs facing South-South trade are almost three times higher than those facing North-North trade: 11.1% and 4.3%, respectively (see Table).

Tariff Reductions are Important

Using the gravity model, which explains bilateral trade by the size of trading partners (GDPs), relative prices, distance and cultural and historical links, we comprehensively analyze bilateral trade flows of 180 countries in the period 1985-2002.

The analysis suggests that in the considered period South-South trade has been significantly impeded by tariffs. It has been estimated that a 10% decrease in South-South tariffs is associated with a 1.6% increase in its trade. This translates to an additional US$5.7 billion in export earnings per year. Interestingly, an equivalent reduction in North-North or North-South tariffs does not result in an equally significant impact on trade flows. Clearly, South-South trade is substantially more sensitive to tariffs compared to trade involving the North. Thus, there is considerable scope for trade policy to boost the trade and welfare of countries in the South.

Simple Average Tariff Rates, 2001, by Exporter and Importer Income groups

Importer / Exporter	High	Upper-Middle	Lower-Middle	Low
High	4.38	8.39	9.72	11.73
Upper-Middle	5.94	8.52	11.83	13.73
Lower-Middle	5.57	9.49	11.06	14.28
Low	3.63	8.72	10.01	13.38

Note: Calculated from MAcMap data

Another interesting finding is that the recent growth in South-South trade has not been brought about by the "death of distance", as there hardly has been any change in the impact of geographical distance on trade in the 1985-2002 period. Additionally, South-South trade is constrained by distance-related trade costs more than other types of trade: it is estimated that whereas a 10% increase in distance tends to reduce North-North trade by about 10%, the comparable figure for South-South trade is 17%. The negative effect of distance-related trade costs is especially strong for low-income countries.

Given that geographical distances facing South-South trade are on average comparable to those facing North-North and North-South trade, the results suggest that there is considerable scope for increasing South-South trade by reducing transport costs to the levels prevailing for other trade flows.

A Third of Global Welfare Gains

What welfare effects can multilateral trade liberalization bring for developing countries? In the computable general equilibrium analysis (CGE) that accompanies the gravity methodology in our paper the benchmark policy scenario is the worldwide non-discriminatory removal of tariffs on merchandise products. Full removal of remaining tariffs is certainly an unrealistic scenario; however it helps us to compare the potential gains from tariff liberalization that can be ultimately achieved through multilateral negotiations with gains from less ambitious scenarios. Our estimates reveal that approximately 57% of the global gains from complete tariff removal accrue to countries in the South of which as much as half are obtained from liberalization by trading partners in the South, i.e. gains from South-South trade account for approximately 28% of global gains. (Currently there is no consensus on the

share of gains form trade liberalization that accrue to developing countries; these depend on the modelling framework and data used. Readers are therefore encouraged to consult results of other existing CGE simulations of tariff reductions). This means that for the countries in the South, South-South tariff liberalization is indeed as important as liberalization by the high income countries.

Sectoral tariff liberalization scenarios considered in the paper suggest that gains accruing to the South from reduction of manufacturing tariffs are comparable to those from reduction of agricultural tariffs. Yet, South-South trade accounts for 58% of gains accruing to the South from the worldwide reduction of agricultural tariffs while the respective share for manufacturing tariffs is 40%. This underlines the importance of South-South trade in agriculture. In manufacturing, North-South liberalization seems to be relatively more important than South-South liberalization from the South point of view but South-South liberalization still brings about sizeable gains.

Overall, the analysis of regional sources of gains from South-South trade suggest that more than half of the gains from South-South tariff liberalization are captured by low and middle income countries in Asia, with China being the largest beneficiary. Yet, only a part of the gains from South-South trade could be realized through regional agreements, mainly in Asia. Many low and middle-income countries benefit most from freer trade with similar countries in other regions. This suggests that multilateral negotiations remain an important vehicle of realising the gains from South-South trade.

Przemyslaw Kowalski is an economist with Trade and Agriculture Directorate, OECD, and Ben Shepherd is with the Development Economics Research Group, the World Bank and with the Groupe d'Economie Mondiale, Sciences Po. *Parts of the paper have been incorporated in Chapter 5 of "Trading Up: Economic Perspectives on Development Issues in the Multilateral Trading System", OECD Trade Policy Studies, 2006. Full paper is available as the OECD Trade Policy Working Paper No. 40 and can be accessed at http://appli1.oecd.org/olis/2006doc.nsf/linkto/td-tc(2006)8-final* **BT**

South–South Trade in Services

Services in many developing countries account for about 50% of their aggregate GDP and employment opportunities, and contribute close to 15% of their total exports. Yet there are virtually no systematic analyses of trends in the structure of services trade among developing countries given the numerous measurement difficulties. Our analysis represents the first attempt to identify key features governing the South-South dimension of services. It is estimated that South-South services exports (covering cross-border trade, the movement of consumers, and, to a limited extent, of suppliers) represented around 10% of world services exports in 2002. There are however important sectoral differences. For example, while South-South exchanges play an important role in world tourism, certain other services such as air transport are estimated to be still heavily dominated by North-North and North-South flows.

Significant geographical concentration of South-South services exports is apparent: exports from Asian developing countries represent around 8% of total world exports, and exports to other developing countries account for more than half of their total exports. Similarly, there is some evidence that for certain Asian and Latin American developing countries, trade with other developing countries exceeds 50% of their total services trade. For the rest, exports to developed countries appear to be more important.

The most important conclusion to emerge from our work is that services trade between developing countries takes place predominantly at the regional level for cross-border trade; movement of consumers; commercial presence and movement of suppliers. This may be due to the increasing tendency to include liberalization of services trade in regional trade agreements.

South-South services exports in general and services trade in particular have the potential to increase. Initially, services trade between more advanced and less advanced countries will be based on the differences in short-term comparative advantage. In the medium to long term, it is technological knowledge that will determine comparative advantage, and enable the development of more advanced services trade.

The elements that influence trade, including policy factors, apply to South-South trade in much the same way that they do to other forms of trade. But the effect of distance on South-South trade in services appears to be less strong than for goods trade. This is consistent with the idea that the main cost involved in services trade is information, rather than transport which pushes up the cost of goods trade. But the analysis also points to the importance of policy barriers, and implies that countries could increase trade in services across all sectors by relaxing restrictions on foreign establishment.

Services liberalization also has a positive and a significant impact on merchandise exports through cheaper transport, communication, and financial infrastructure. In addition, productivity gains in services which are direct inputs into producing merchandise can increase the competitiveness of firms.

One significant fact to note is that the impact of lifting restrictions on performance may increase more than proportionally with the scale of the liberalization measure. This may mean that it is not enough to liberalize moderately in order to achieve an impact on performance if the initial degree of restrictiveness is high. Preliminary results suggest that if services sectors are closed to foreign competition, the improvement of their performance requires a major rather than a small or moderate liberalization effort.

The authors are Nora Dihel (OECD Trade Directorate), Felix Eschenbach (Groupe d'Economie Mondiale, Sciences Po) and Ben Shepherd (affiliated at the time of writing with the Groupe d'Economie Mondiale, Sciences Po). *The article is based on "South-South Services Trade", OECD Trade Policy Working Paper No. 39 (http://appli1.oecd.org/olis/2006doc.nsf/linkto/td-tc(2006)7-final). Parts of the paper have been incorporated to Chapter 5 of "Trading Up: Economic Perspectives on Development Issues in the Multilateral Trading System", OECD Trade Policy Studies, OECD, 2006* **BT**

President Wolfowitz Hails Economic Reforms, Bank Partnership, in Turkey

World Bank Group President Paul Wolfowitz traveled to Turkey from January 27 to 29. During the two day trip, he met with a low-income family benefiting from a Bank supported conditional cash transfer program, and with youth groups and civil society organizations; toured modern International Finance Corporation-supported glassmaking and paper packaging factories; and visited men in a homeless shelter in downtown Istanbul. Mr. Wolfowitz had what he called "extremely good meetings" with Prime Minister Tayyip Erdogan and State Minister for the Economy Ali Babacan, focusing on a range of topics, including Turkey's economic reforms, the challenge of the country's unemployment, and Turkey's prospects for membership in the European Union. Mr. Wolfowitz noted that the very reforms that will benefit Turkey's development in the long run are also the reforms on the path toward EU accession. For more information, visit: *http://www.worldbank.org/president*

Report Looks at 2007 Economic Prospects for Newest EU Members

Output growth gained further pace across the region in 2006 but is likely to moderate slightly in 2007, according to the World Bank's latest *EU8+2 Regular Economic Report*, launched on January 25. The report indicates that real GDP growth strengthened in the region, not least in Poland, Slovakia, and Romania, as dynamics improved further in the second half of the year, but the Baltic States, Slovenia, and Bulgaria also grew at an even stronger rate than the year before. This occurred in spite of currency appreciation against the euro, and especially the dollar, in several countries, as well as some moderation in growth in the euro area. Meanwhile, oil prices declined significantly from September and further in early 2007. The report predicts that growth is likely to ease in most of the new member states in 2007 as growth slows in the euro area and output moves closer to potential. The previous *EU8 Quarterly Economic Report* series has been extended to include new EU member states Bulgaria and Romania in addition to the eight Central European and Baltic countries that joined the EU in 2004. The new *EU 8+2 Regular Economic Report* will continue to monitor the macroeconomic and reform developments in the EU 8+2 countries and provide both an up-to-date summary of economic developments in the region and in-depth analyses of key current economic policy issues. For more information, visit: *http://www.worldbank.org/eca/eu10rer*

Newly–Independent Montenegro Joins World Bank Group

The Republic of Montenegro became the newest member of the World Bank Group on January 18 when Finance Minister Igor Luksic signed the Articles of Agreement of the International Bank for Reconstruction and Development (IBRD). Montenegro is the 185th member of the IBRD. In addition to becoming a member of IBRD, Montenegro joined the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). The World Bank Group is developing a new four-year strategy for Montenegro, in consultation with authorities and stakeholders in the country. In addition to financing and research offered to the Montenegrin government by IDA and IBRD, the Bank Group, through IFC and MIGA, will also continue to offer support to encourage private sector investments in Montenegro. New support will build on support that the World Bank Group has provided to Montenegro since a separate program was established in 2001. Active World Bank lending projects that are currently being implemented by the government of Montenegro total slightly over US$30 million, while the IFC currently has a total portfolio of private sector investments in Montenegro valued at over US$18 million. For more information, visit: *http://www.worldbank.org/montenegro*

New Migration Report Analyzes Potential Benefits of Migration

Migration can benefit both sending and receiving countries and reduce poverty among migrants if it is better coordinated between countries, according to the new World Bank report, *Migration and Remittances: Eastern Europe and the Former Soviet Union*, launched on January 16 in Brussels. Migration within and from the transition economies of Europe and Central Asia has been large and will likely continue to increase as declining birthrates across much of the region will lead to an increased demand for a young labor force. To ensure that migration benefits both sending and receiving countries and the migrants themselves, countries could more closely coordinate their policies so that the supply of migrant labor can meet demand through legal channels that respect the rights of migrants and are politically and socially acceptable to migrant-receiving countries. There are no readymade solutions for effective migration policy, yet one possible route might be to combine short-term migration with incentives for return or circular migration. Circular migration could allow migrants to spend short periods of time abroad without creating new amounts of permanent migration. For more information, visit: *http://www.worldbank.org/eca/migration*

New Bank Strategy for Russia Adapts Partnership to Russia's Realities

The World Bank's Board of Executive Directors endorsed on December 14, 2006 a new three-year Country Partnership Strategy for Russia that marks a shift towards new ways of cooperation focused on knowledge sharing, increased technical advice and financing to the country's regions, and new fee-for-service arrangements for investment and policy advice, combined with continued strong levels of financing for the private sector and limited financing for assistance in managing priority public investments. The Strategy builds on Russia's recent accomplishments yet recognizes that important development challenges remain. Russia has experienced five years of strong economic growth and poverty reduction. Furthermore, sharp increases in the prices of Russia's main export commodities, particularly oil and gas, have filled the coffers of the federal government, and provided for the accumulation of over US$300 billion in monetary and fiscal reserves. Russia's global role as a G8 member, emerging donor, and provider of world energy has expanded notably. Accordingly, recent years have witnessed the beginning of a

major transition in the nature of cooperation between the World Bank Group and the Russian government. For more information, visit: *http://www.worldbank.org/ru*

Georgia Investment Climate Forum Features Successful Reforms

Georgian Prime Minister Mr. Zurab Nogaideli highlighted Georgia's reforms since the Rose Revolution, including in the business environment, education, and energy, at a symposium on December 13, 2006, hosted by the World Bank Group and the U.S. Department of Commerce's BISNIS unit. Georgia has made great strides in several sectors, including its investment climate, as evidenced by the World Bank/International Finance Corporation's annual *Doing Business* survey, as well as the 2005 joint World Bank/EBRD's *Business Environment and Enterprise Performance Survey*. In addition to the investment climate, the Prime Minister touched upon energy and infrastructure improvements, education reforms including objective testing methods in university entrance exams, targeted poverty benefits for the poorest, new liberal labor regulations enacted in May 2006, and reduced tariff rates-with the bulk of imports now carrying no duties. The symposium concluded with the signing of a Credit Agreement for the First East-West Highway Improvement Project for US$19 million in the presence of the Prime Minister and Vice-President Shigeo Katsu. For more information, visit *http://www.worldbank.org/ge*

Moldova's Donors Meeting Evaluates Funding Priorities

The government of Moldova and its international partners convened on December 12, 2006, in Brussels for a Consultative Group Meeting. The objectives were twofold: (a) to assess progress and to confirm commitment in the implementation of the country's reform program and development agenda, as set out in the EU-Moldova European Neighborhood Policy Action Plan and the Moldova Economic Growth and Poverty Reduction Strategy Program, and (b) to provide indications of additional external financing in response to recent external shocks that have opened a short-term financing gap, putting Moldova's poverty reduction and growth objectives in question. The meeting was jointly hosted by the European Commission and the World Bank. The Government delegation was led by Prime Minister Vasile Tarlev. All key development partners were represented. Partners and government agreed that the further economic and social development of Moldova as well as the close relationship between the country and the international community hinges on a continued strong will in Moldova to implement political, social and economic reforms. For more information, visit: *http://www.worldbank.org/md*

Bank Strategy for Azerbaijan Supports Continued Reforms

The World Bank's Board of Executive Directors discussed a new Country Partnership Strategy for Azerbaijan on December 7, 2006. The Country Partnership Strategy is a central document defining the World Bank Group's support to Azerbaijan to meet the country's key development challenges, including reducing poverty, modernizing infrastructure, and improving governance and social services. The strategy guides all Bank operations in the country lending, analytical work and technical assistance. The new partnership strategy covers a four-year period from 2007 to 2010, and envisages a lending program of US$1.26 billion, both in IDA and IBRD financing, as well as an active IFC program. Knowledge sharing, analytical and advisory activities and development partnerships will reinforce these investments. The strategy supports the main objective of the government's long-term program to reduce poverty and achieve the Millennium Development Goals by fostering economic diversification and growth, particularly in non-oil sectors, while maintaining macroeconomic stability; improving health, education and infrastructure services; strengthening social protection; and addressing important environmental issues and implementation of the climate change agenda. For more information, visit: *http://www.worldbank.org/az*

Roma Decade Event Moves Forward with Plans for Monitoring

A new initiative by Roma organizations to monitor implementation of National Decade Action Plans, as well as a commitment to provide cross-country support using an international trust fund, were endorsed at the Decade of Roma Inclusion's November 16-17, 2006 meeting of its International Steering Committee in Sofia, Bulgaria. "DecadeWatch," a means to monitor the Decade countries' execution of their National Decade Action Plans, is being prepared in the nine Decade countries by Roma researchers, supported by the Open Society Institute and the World Bank. Cross-country support through sharing of best practices will be enabled by the Decade Trust Fund, to which Decade countries and international organizations such as the OSI have committed funds. The Decade of Roma Inclusion is the first international effort designed to improve the lives of Roma and include them in the societies in which they live. The Decade is an initiative of nine countries in collaboration with donors, including the OSI and the World Bank. It sets forth national targets in four priority areas: education, housing, employment, and health. For more information, visit: *http://www.romadecade.org*

Kosovo Lignite Power

Kosovo moved one step closer to developing the potential of its large energy reserves after the World Bank's Board of Executive Directors approved on October 12, 2006, an US$8.5 million grant aimed at supporting development in Kosovo, which suffers from high unemployment and chronic electricity cuts. The Lignite Power Technical Assistance Project grant from the World Bank's International Development Association comes in response to a request by the Kosovo Provisional Institutions of Self-Government, which asked the World Bank, the European Commission, and several bilateral donors to support Kosovo's development agenda by facilitating investments in key sectors of the economy with high growth potential. The grant will help the PISG to put in place the right regulations and laws to allow private investors to start bidding in 2007, begin construction in 2008, and complete the power plant in 2012. For more information, visit: *http://www.worldbank.org/kosovo*

This section has been provided courtesy of Merrell Tuck and Christina Lakatos, Europe and Central Asia External Affairs. **BT**

World Bank Publications

Information and orders: the World Bank, P.O. Box 960, Herndon, VA 20172, U.S.; tel.: +1-703-661-1580, fax.: 703-661-1501, email: books@worldbank.org, www.worldbank.org /publications, or visit the World Bank InfoShop at 701 18th Street, N.W., Washington, D.C., tel.: +1-202-458-5454.

Alan Winters, Shahid Yusuf, eds.
Dancing with Giants: China, India, and the Global Economy
Published January 2007 by Institute of Policy Studies (Singapore)
ISBN: 0-8213-6749-8 ISBN-13: 978-0-8213-6749-0 SKU: 16749

China is now the world's fourth largest economy and growing very fast. India's economic salience is also on the rise. Together these two countries will profoundly influence the pace and nature of global economic change. Drawing upon the latest research, this volume analyzes the influences on the rapid future development of these two countries and examines how their growth is likely to impinge upon other countries. It considers international trade, industrialization, foreign investment and capital flows, and the implications of their broadening environmental footprints. It also discusses how the two countries have tackled poverty, inequality and governance issues and whether progress in these areas will be a key to rapid and stable growth.

Global Economic Prospects 2007: Managing the Next Wave of Globalization
Published December 2006
ISBN: 0-8213-6727-7; ISBN-13: 978-0-8213-6727-8 SKU: 16727

Over the next 25 years developing countries will move to center stage in the global economy. Global Economic Prospects 2007 analyzes the opportunities — and stresses — this will create. While rich and poor countries alike stand to benefit, the integration process will make more acute stresses already apparent today — in the areas of income inequality, labor markets, and the environment. Rapid technological progress, trade in goods and services, and integration of financial markets create the opportunity for faster long-term growth. However, some regions, notably Africa, are at risk of being left behind. The coming globalization will also see intensified stresses on the "global commons". Addressing global warming, preserving marine fisheries, and containing infectious diseases will require effective multilateral collaboration to ensure that economic growth and poverty reduction proceed without causing irreparable harm to future generations.

World Bank Working Papers

http://econ.worldbank.org

Ben Shepherd, John S. Wilson
Road Infrastructure in Europe and Central Asia: Does Network Quality Affect Trade?
WPS4104, December 2006

The authors present a new database of minimum distance road routes connecting 138 cities in 27 countries across Europe and Central Asia. The data show that improved road network quality is robustly associated with higher intraregional trade flows. Gravity model simulations suggest that an ambitious but feasible road upgrade could increase trade by 50% over baseline, exceeding the expected gains from tariff reductions or trade facilitation programs of comparable scope. Cross-country spillovers due to overland transit are important: total intraregional trade could be increased by 30% by upgrading roads in just three countries — Albania, Hungary, and Romania.

Assar Lindbeck
An Essay on Economic Reforms and Social Change in China
WPS4057, November 2006

The author applies a systems-oriented "holistic" approach to China's radical economic reforms during the past quarter of a century. When looking at the economic consequences of China's change of economic system, he deals with both the impressive growth performance and its economic costs. The author also studies the consequences of the economic reforms on the previous social arrangements in the country, which were tied to individual work units-agriculture communes, collective firms, and state-owned enterprises. He continues with the social development during the reform period, reflecting a complex mix of social advances, mainly in terms of poverty reduction, and regresses for large population groups in terms of income security and human services, such as education and, in particular, healthcare. Next, the author discusses China's future policy options in the social field, whereby he draws heavily on relevant experiences in industrial countries over the years.

Shubham Chaudhuri, Martin Ravallion
Partially Awakened Giants: Uneven Growth in China and India
WPS4069, November 2006

Drawing on analyses based on existing household survey data and aggregate data from official sources, the authors show that growth in China and India has been uneven at the geographical, sectoral, and household level, and that this has meant uneven progress against poverty, less poverty reduction, and an increase in income inequality. The discussion is structured around the idea that there are both "good" and "bad" inequalities in terms of what they imply for both equity and long-term growth and development. The development paths of both China and India have been influenced by, and have generated, both types of inequalities. The authors argue that policies are needed that preserve the good inequalities, such as continued incentives for innovation and investment, but reduce the scope for bad ones, notably through investments in human capital and rural infrastructure that help the poor connect to markets.

Thomas Rutherford, David Tarr
Regional Impacts of Russia's Accession to the World Trade Organization
WPS4015, September 2006

The authors develop a computable general equilibrium model of the regions of Russia to assess the impact of accession to the WTO on the regions of Russia. They estimate that the average gain in welfare as a percentage of consumption for the whole country will stand at 7.8% (or 4.3% of consumption); they estimate that three regions will gain considerably more: Southwest (11.2%), St. Petersburg (10.6%) and the Far East (9.7%). The principal explanation for the differences across regions is the ability of the regions to benefit from a reduction in barriers against foreign direct investment. The three regions with the largest welfare gains are clearly the regions with the estimated largest shares of multinational investment. Thus, regions may gain more from WTO accession if they can succeed in creating a good investment climate.

Lire Ersado
Rural Vulnerability in Serbia
WPS4010, September 2006

The author analyzes the nature, extent, and causes of rural vulnerability in Serbia using panel national household data from the 2002 and Serbia Living Standard Surveys from 2003. He measures rural vulnerability as a function of determinants of poverty and the exposure to risk. While low levels of consumption (poverty) explain about 70% of vulnerability, the author finds that risk and uncertainty account for the remaining 30%. Households and regions with a greater share of their livelihood depending on agricultural activities are more at risk of vulnerability than those with a significantly higher share of income coming from nonagricultural sources. Rural vulnerability to poverty and risk is also strongly associated with asset ownership and access to markets.

UCL School of Slavonic and East European Studies (SSEES)

http://www.ssees.ac.uk/economic.htm

Kate Bishop
Knowledge Based Entrepreneurship in the Czech Republic and Hungary: Results from Four Case Studies
WP 71, December 2006

This paper describes the growth and development process of four firms in the two countries: an environmental services firm, an IT services firm, a data recovery firm, and a biopharmaceutical firm. The objectives of the case studies are to illustrate experiences of knowledge based entrepreneurship within a transition environment in terms of their different growth and development paths using the ecological conceptual framework.

Brigitte Granville and Carol S. Leonard
Do Institutions Matter for Technological Change in Transition Economies? The Case of Russia's 89 Regions and Republics
WP 70, December 2006

The authors explore the impact of institutions on technological change in a transition economy. They use regional panel data for Russia's 89 regions and republics during the period of recovery and growth from 1998 to 2004 to show the impact of large variation in institutional development, ranging from full enforcement of property rights in the Northwest to communist regimes in the Southeast. They find an unambiguous relationship between strong and sustained institutional development, represented by investment risk rating, and technological change.

Ruta Aidis and Yuko Adachi
Russia: Firm Entry and Survival
WP 67, September 2006

Why are there so few new firms in Russia? This paper provides further insights into the specific Russian business landscape and how it impacts the low level of new firm entry. As this paper indicates, internationally comparative data does not provide many clues since in terms of purely formal constraints, Russia fairs comparatively well. However, a deeper analysis uncovers the informal impediments associated with the lack of rule of law, inconsistent enforcement of regulations, regional autonomy and pervasive corruption. These informal constraints form impediments not only for new firm creation but also for firm survival and firm exit. Since not all industries are affected in the same way, this paper includes a comparison between a new and traditional industrial sector: software development and the textile industry.

Other Publications

Transition Report 2006: Finance in Transition
EBRD Report, ISBN: 1 898802 28 9, ISSN: 1356-3424, www.ebrd.org

The special theme of the report is devoted to an analysis of the financial sector in transition countries. Making use of several unique data sources, the report looks at how financial systems have been restructured over the past 15 years, their impact on the economy and private sector development and the introduction of new financial services. The main conclusions of the report include:

- Progress in reform has been maintained
- Strong growth continued throughout the region in 2006
- Financial markets have grown in size, complexity and stability
- Public and private equity markets have emerged but bank-based systems dominate
- Continuing scope for improving the quality of institutions and the operating environments
- Potentially large growth dividend from further financial deepening

Janos Kollo
Workplace Literacy Requirements and Unskilled Employment in East-Central and Western Europe
Institute of Economics Hungarian Academy of Sciences, BWP — 2006/7, December 2006, http://www.econ.core.hu

Primary degree holders have extraordinarily low employment rates in Central and East European (CEE) countries. The

paper looks at the possible role for skills mismatch in explaining this failure. The analysis is based on data from the IALS, an international skills survey conducted in 1994-98. The results suggest that selection to skill-intensive jobs was more severely biased against the less-educated in the CEEs (Czech Republic, Hungary, Poland and Slovenia) than in the rest of Europe including countries hit by high unskilled unemployment at the time of the survey (UK, Ireland, Finland). The paper concludes that the skill deficiencies of workers with primary and apprentice-based vocational qualifications largely contribute to the unskilled unemployment problem in the CEEs more than they do in mature European market economies.

Zuzana Fungacova and Jan Hanousek
A Castle Built on Sand: The Effects of Mass Privatization on Stock Market Creation in Transition Economies
BOFIT Discussion Papers No 14 / 2006, http://www.bof.fi

This paper deals with the relationship between mass privatization and stock market development in transition economies. The link is investigated empirically using a panel of data that includes most transition countries. Our results confirm the hypothesis that mass privatization exerted a negative influence on stock market functioning over the short and medium term. Further, it appears that stock markets in countries with mass privatization were initially perceived as mere byproducts of the privatization process. Such stock markets typically not only failed in their core mission of providing capital for the corporate sector, but generated negative investor sentiment and did little to catalyze economic growth.

Book Reviews

Tomasz Mickiewicz
Economic Transition in Central Europe and the Commonwealth of Independent States
First published 2005 by Palgrave Macmillan, Houndmills, Basingstoke, Hampshire RG21 6XS; ISBN 1-4039-4162-9

Fifteen years ago, 27 countries in Europe and Central Asia embarked on their economic transition path. For some, the outcome was a considerable success. Several others are still struggling to shed the inheritance of the past and to correct more recent policy mistakes. The author starts his book by discussing the old regime and the reasons for the slowdown and ultimate demise of the command economy system. Then he introduces the main components of the reform program and discusses the interdependence between stabilization, liberalization and the "hardening" of the budget constraint. The author then turns to the process of privatization, which was the key aspect of institutional change and concludes the first part of the book with a discussion of unemployment and why labor market outcomes were so different in the various transition economies. In the second part the author asks possibly the most fundamental questions: why some countries went through a ten-year long recession, while others emerged from the post-communist recessions after a mere two years? Why was fiscal performance so different? Was democracy a factor that facilitated reforms or, rather, slowed them down? The book discusses these questions in the context of new empirical evidence, including a critical examination of the main themes in the economics of transition literature.

Tomasz Mickiewicz (Ed.)
Corporate Governance and Finance in Poland and Russia
First published in 2006 by Palgrave Macmillan, Houndmills, Basingstoke, Hampshire RG21 6XS; ISBN 0-230-00795-3

This book is a compendium of articles written by researchers from different countries who are working extensively in the field of corporate governance and finance. The book provides a comparative analysis of the emerging corporate control structures in the transition economies and details characteristics of corporate governance and finance in the two largest transition economies: Russia and Poland. It explores what kind of ownership structures are emerging in these two countries and to what degree they are path-dependent and conditional on the initial choice of privatization methods — fast ownership transfer through the mass privatization program and loans-for-equity scheme in Russia, or a more "organic" growth of the new private sector in Poland. It examines the directions of the subsequent, post-privatization, secondary ownership flows in both countries and the impact of the government on corporations, implied both by the residual shareholding and by its regulatory and administrative actions. What makes the comparison between Russia and Poland most interesting is the fact that while the economic systems in the two countries were very similar to start with, their corporate structures evolved in different directions. This book aims to enhance understanding why.

David Lane and Martin Myant (Eds.)
Varieties of Capitalism in Post-Communist Countries
First published in 2007 by Palgrave Macmillan, Houndmills, Basingstoke, Hampshire RG21 6XS, ISBN 1-4039-9641-5

Former communist countries in Eastern and Central Europe, the CIS and Asia have, over recent years, transformed or reformed their economies. This book addresses the question of how far they have changed into capitalist systems and, if so, what kind of capitalism they have developed, or are developing. This collection of papers has been the subject of two conferences of participants — held at the University of Cambridge in 2004 and at the University of Paisley in 2005. This book sets the experience of transition countries against the "varieties of capitalism" paradigm, as developed by authors using an approach based on institutional economics. By avoiding the assumption that all transformations must lead to one kind of market economy, it provides a framework for comparing the courses and current outcomes of very different transformation processes. However, it becomes clear that the rather different heritages of the communist and even pre-communist pasts mean there is no close fit with the ideal types used for analyzing and comparing mature market economies. The work therefore has implications for the more general discussion of differences between kinds of capitalism, pointing to the need to place more emphasis on change and development and hence on political and social interests. **BT**

CEPR/Swedish Development Economics Network Conference on Development Economics

March 9, 2007, Stockholm, Sweden

CEPR Development Economics Program and Swedish Development Economics Network are organizing a joint conference on development economics. The conference is funded by the Swedish International Development Agency. The goal of the conference is to provide a forum for work in development economics and to bring together economists in the field from across Europe and researchers from outside the region. The participants will present both theoretical and empirical papers in any area of development economics broadly defined.

More information: http://www.cepr.org/Meets/diary/listyear.asp?year=2007

Fifth International CASE Conference "Winds of Change: The Impact of Globalization on Europe and Asia"

March 23-24, 2007, Kiev, Ukraine

With high growth rates in China, South East Asia, India and Central Asia the economic center of gravity of Eurasia is quickly shifting to the East. The same is true as regards to population. At the same time most of Europe faces serious growth barriers in the long term. The conference will look at the causes and consequences of this major shift in economic power and political potential and consider options faced by policymakers in various parts of Europe and Asia. Discussion will include themes such as differences in growth performance, the nature of global imbalances, changing directions of goods, capital and aid flows, the challenges of migration and emerging regional integration models. The conference will contain six thematic sessions and three keynote addresses. It will gather 200-250 participants from more than 30 countries.

To register, go to: http://aries.case.com.pl/register/. To read conference papers, go to: http://www.case.com.pl/strona--ID-winds_papers,nlang-710.html

2007 Spring Meeting of the World Bank Group and the International Monetary Fund

April 14-15, 2007, Washington, D.C.

Around these meetings, the IMF and World Bank organize a number of forums to facilitate the interaction of governments and IMF-Bank staff with NGOs, journalists, and the private sector. Every effort is made to ensure that the annual meetings provide an effective forum for explaining to the public-directly and through the media-the tasks, objectives, and outcomes of the work of the IMF and the World Bank. At least 10,000 people attend, including about 3,500 members of delegations from the member countries of the IMF and the World Bank, roughly 1,000 representatives of the media, and more than 5,000 visitors and special guests drawn primarily from private business, the banking community and NGOs.

More information: http://web.worldbank.org/

EBRD 2007 Annual Meeting and Business Forum

May 20-21, 2007, Kazan, Russia

This annual event brings together investors and corporate executives, regional entrepreneurs, government officials and other policy makers. To request an invitation visit: *http://www.ebrd.org/new/am/index.htm.*

General inquiries: Office of the Secretary General, Tel.: +44 (0) 20 7338 6625, Fax: +44 (0) 20 73387320, E-mail: aminvitations@ebrd.com.

CEU Summer University 2007

July 4-27, 2007, Budapest, Hungary

In 2007 CEU Summer University will offer 15 courses. The program encourages applications from advanced Ph.D. students, postdoctoral fellows, junior faculty, researchers and professionals. The CEU Summer University program welcomes course proposals both from CEU and non-CEU faculty from all over the world. The next submission deadline for new courses in 2008 is May 17, 2007.

Inquiries should be directed to Eva Gedeon, Executive Director of SUN. E-mail: gedeone@ceu.hu, Tel: +36-1 327-3069, http://www.sun.ceu.hu/2General/proposal.php

Annual Conference of the European Association of Labor Economists

September 20-22, 2007, Oslo, Norway

The aim of the conference is to facilitate the exchange of research ideas and results across a range of fields in Labor Economics. The conference will be organized by the Department of Economics, University of Oslo, Institute for Social Research, and the Frisch Centre. The electronic submission form for paper contributions will close after the deadline of March 1, 2007. The registration site will be open from May 1, 2007. Papers accepted for presentation can be submitted again for publication in the annual conference volume of the journal "Labor Economics".

More information: http://www.eale.nl/Conference2007/Callforpapers.htm

Business and Marketing Strategies for Central and Eastern Europe

November 29-December 1, 2007, Vienna, Austria

15th Annual conference is organized by DePaul University Chicago and Vienna University of Economics and Business Administration.

Empirical research, case studies or discussion sessions are sought which address such topics as comparative analysis of conditions of market entry in CEE countries, market entry through exports versus market entry via capital investment, acquisitions as opposed to joint ventures in CEE, marketing strategies to reach CEE consumers, marketing-mix-decisions for markets in CEE, financial strategies for opening CEE markets, case studies of CEE experiences by western firms. Abstracts of the papers, should be received by September 15, 2007. The final papers must be ready by November 1, 2007.

More information: Prof. Dr. Reiner Springer, Vienna University of Economics and Business Administration, Phone: +43-1-313 36/4377, FAX: +43-1-313 36/751, E-mail: Reiner.Springer@wu-wien.ac.at or Prof. Dr. Petr Chadraba, Department of Marketing, College of Commerce, DePaul University, USA, Phone: (312) 362-6889, FAX: (312) 362-5647, E-mail: pchadrab@depaul.edu **BT**

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