Mongolia and Central Asia in Transition

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Abstract

In this article, Mongolian economic performance during its major transition period is compared with the economic performance of Central Asian transition countries. In particular, the following key areas are examined: output performance, privatization and liberalization policies, foreign direct investment, inflation, poverty, problems of economic management, foreign trade, and exchange rate policies. The results of the study show that Mongolia became a rapid reformer and has been fairly successful over its transition despite starting with economic crises. The comparative study with Central Asian transition countries demonstrate that Mongolia compares favorably with most of the Commonwealth Independent State (CIS) countries. Despite external shocks and some less than successful policy implementations, inflation slowed, output declined less sharply, and the first positive growth in GDP was made.

Keywords: Central Asia, Mongolia, reform policy, transition economy.

Introduction

Most of the former planned economies have undertaken economic reforms aimed at replacing central planning with a market economy. There is not, of course, a single process of transition, a process that has affected the lives of approximately one-third of the world population (Nolan 1995). Neither the People's Republic of China nor Vietnam have formally renounced their socialist development objectives, but in most of the transitional economies, including Mongolia, the aim has been to achieve as rapidly as possible economic, political, social, and institutional change, largely rejecting the old economy and its institutions and attempting to replace them with some notions of a market economy.

The transition process in global terms is dominated by China and Russia. The start of economic reform in China is usually dated from December 1978, although reforms began immediately after the death of Mao Zedong. Remarkable measures taken in the PRC included the dissolution of agricultural communes and the development of township and village industries outside the web of official price controls and state planning. Output grew rapidly, and inflationary pressures were negligible for the first few years (Rana and Naved 1995). In Russia, Mikhail Gorbachev first outlined *glasnost* (openness) as a policy in 1986. In the same year, Vietnam also initiated policies of *doi moi* (innovation), although real change did not begin until 1989, and the Lao PDR adopted gradualist reform programs in 1986. By 1989, the transition from central planning to a greater market orientation had became a political imperative throughout Eastern Europe and the then USSR. Mongolia moved to a multiparty political system in 1990 with equally rapid political, constitutional, and economic changes. The countries of Central Asia – Kazakhstan, Kyrgyzstan Turkmenistan, Tajikistan, and Uzbekistan – emerged as independent states from the disintegration of the USSR at the end of 1991, and since their independence these countries have been striving to carry out market and political reforms.

A great lesson has been learnt from these various experiences of transition, and the relevant literature is dominated by the argument that economic reforms should be comprehensive, rapid, consistent, and sustained. However, there are many economists who criticize this idea. Nolan (1995) discusses in great detail the transition experiences of China and Russia, pointing to the different outcomes of the transition in terms of its impact on economic growth, inflation, and socioeconomic indicators. Controversy thus remains as to how the process of transition should be managed, its speed, and the role of the state in that process.

As observed by Cukrowski (2006): "The economies of Mongolia, Kazakhstan, the Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan were centrally planned during the Soviet era and followed development strategies determined in Moscow." Despite some similarities of economic structure, these countries have pursued different development strategies since the early 1990s, when the first multiparty election was held and a coalition government was established in Mongolia, and when the other Central Asian countries gained their independence.

In 1991, when the Soviet Union collapsed, all six countries were subject to several external shocks: an aid shock, a trade shock, and a macroeconomic management shock. Soviet aid was reduced considerably in 1989 and then terminated in 1991. It is estimated that the aid shock was equivalent to around 30%–35% of GNP of these countries. Entire investment programs were financed by the Soviet Union in the form of loans, and there was small but regular investment by the state in these countries. The collapse of the Council for Mutual Economic Assistance (CMEA) delivered a trade shock to all of these countries. They suddenly lost much of their trade, particularly their export markets, and the sharp fall caused severe foreign exchange constraints. In addition to these difficulties, there was also the macroeconomic management shock created by the return of experienced senior technical advisers to the Soviet Union. The management of state expenditure in investment and production suddenly became more difficult without experienced advisors in the new economic system (Griffin 1995: 14).

Not surprisingly, therefore, the transition to the market economy did not proceed smoothly. Diverse economic strategies were adopted by national governments and economists, despite the similarities of traditional political and economical structures. Mongolia began its rapid reform programs under the leadership of the Communist Party, and adopted a big-bang strategy of rapid transformation of property rights, accompanied by administrative controls and price liberalization (Pomfret 2000). Kyrgyzstan took advice from the World Bank and the International Monetary Fund (IMF), which advocated rapid changes and the rapid launching of reform programs in the region. Turkmenistan was at the opposite end of the spectrum, as the president personalized absolute authority and limited economic change. Kazakhstan initially appeared to follow a liberal path, but the government took an important role once again. Uzbekistan retained a tightly controlled political system, and has been slow in undertaking economic reforms. Tajikistan experienced civil war in 1991–92 and 1996–97, and delayed the implementation of the political and economic reforms (Pomfret and Anderson 2003: 75).

This article covers Mongolia and the Central Asian countries of Kazakhstan, Kyrgyzstan, Turkmenistan, Tajikistan, and Uzbekistan. As these countries are at different stages in their transition from central planning, their experiences provide useful material for comparative analysis. The first objective is to conduct a comparative analysis of the transition process in Mongolia and the Central Asian countries, identifying and comparing the initial conditions and the major reform measures adopted. The second objective is to conduct a comparative analysis of the performance of these economies with regard to developments in key macroeconomic variables. The final aim is to identify similarities and differences in the transition processes in these countries, and the lessons that can be learned.

Initial Conditions and Reform Programs

Democratic Mongolia and the newly independent countries in Central Asia started from fairly similar initial conditions. Before the transition in Mongolia, there had been some modest reforms intended to create a new economic system; however, these reforms were unsuccessful. In the Soviet Union, some reform programs had taken place in Baltic republics under Gorbachev's supervision; however, these reforms were absent in Central Asia. In order to create the fundamental conditions for a market system, these six transitional Asian countries had to overcome various serious distortions that they inherited from the command economy under the Soviet Union. It should be noted, however, that the inheritance from the Soviet Union also included several positive points:

- the presence of many pivotal branches of industry and agriculture;
- a rather well-developed economic and social infrastructure;
- positive social indicators (Table 1), including high levels of elementary, secondary, and tertiary education among the population, limited inequality in the distribution of income among various groups within the population, a low rate of infant mortality compared with other developing countries, and high life expectancy.

Table 1. Initial conditions in 1990: Selected social indicators

Country	Primary school enrollment (gross)	Life expectancy at birth (years)	Infant mortality rate per 1000 live births	Adult literacy rate (% of people aged 15 and above)	PPP GDP per capita USD
Mongolia	90	63	55.5	94.24	1331
Kazakhstan	89	68	63.0	97.53	4650
Kyrgyzstan	92	68	58.0	96.71	2038
Tajikistan	77	63	91.0	97.67	2002
Turkmenistan	82	63	80.0	98.96	4405
Uzbekistan	78	64	57.0	96.22	1499
Least developed countries	63.7	45.6	121.0	52.4	1053

Source: "Human Development Report 2000: Human Rights and Human Development": United Nations Development Program (UNDP) 2000; "Human Development Report for Mongolia: Reorienting the State": UNDP 2000.

Despite these positive elements inherited from the Soviet Union, there were also certain problems such as structural distortion in the development and distribution of various levels of production and an inefficient system of economic management. Therefore, all these countries had to begin the fundamental restructuring of their national economies. As they undertook these programs, they also faced similar conditions:

- A high degree of emphasis on raw materials production. On the one hand, the roles of Mongolia and the Central Asian republics in the Soviet system were those of producers and suppliers of raw materials to the Soviet Union. On the other hand, they were significant markets for the sale of finished goods from Russia and the Baltic republics. Like Mongolia, all the Central Asian countries produced semi-finished goods or performed only part of the production cycle. Thus, the economies of these transition countries did not develop as integrated, self-contained complexes. As a result, output from Central Asian industries that produced finished goods accounted for only a small portion of total production. In addition, production of goods that could compete in the international market was nonexistent. For instance, the Mongolian economy was dominated by the livestock and minerals sectors. Its role was to export meat, gold, and copper to the Soviet Union. Kazakhstan relied on exports of grain, minerals, and energy resources, while Uzbekistan was a cotton producer. Unlike Kyrgyzstan and Tajikistan, where exploitable resources are rare, Turkmenistan experienced a boom in natural gas production just before the collapse of the Soviet Union.
- A high level of dependence on food imports (with the exception of Kazakhstan) and consumer goods. All of these countries imported their essential food products and consumer goods from the Soviet Union.
- A high level of dependence on state investment policies. Almost 100% of all investments in these countries were financed in the form of Soviet Union aid or loans. Generally, only investment projects approved by Moscow were financed.

The most industrially developed of these countries was Kazakhstan. Mongolia, Uzbekistan, Tajikistan, and Kyrgyzstan differed from Kazakhstan in two ways. First, these countries had the lowest standards of living among the former Soviet republics and satellites. In particular, their per capita incomes amounted to just half of the average in the other Soviet Union republics. According to official data, in 1989 approximately 40%–45% of the families in these countries lived below the poverty line, with incomes below the minimum wage (de Mello et al. 1997). Second, these countries suffered from an acute unemployment problem, especially in rural areas, although official statistics did not provide information on unemployment and poverty within the USSR and socialist Mongolia. The official position was that full employment existed in these countries and that therefore poverty was impossible (Pomfret 1995: 61). In demographic terms, more than half of the population consists of children, students, and pensioners. Moreover, the majority of the population in Kazakhstan, Uzbekistan, Tajikistan, and Turkmenistan is Muslim; they have their own way of life, communal forms of organization, and a low propensity for migration. As Table 2 indicates, the share of industry in these countries was lower than average, compared with other USSR, Eastern European, and East Asian countries. The highest rate of industrialization occurred in Mongolia, which was equal to the average of the CIS countries. In the beginning of the transition, the degree of openness of the economy was weak, which can be shown by the liberalization index. Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, Mongolia, and the former Soviet

Central Asian republics, experienced a longer period of around 70 years, under central planning compared with other transition countries.

Table 2. Initial conditions: Selected indicators

Country	Share of industry in GDP	Liberalization index	Years under central planning	PPP Income per capita USD	CMEA trade % of GDP
	1990	1989		1989	1990
Mongolia	0.41	0.04	70	2100	31
Kazakhstan	0.34	0.04	71	5130	20.8
Kyrgyzstan	0.4	0.04	71	3180	27.7
Tajikistan	0.34	0.04	71	3610	31
Turkmenistan	0.34	0.04	71	4230	33
Uzbekistan	0.33	0.04	71	2740	25.5
USSR	0.41	0.04	70	4755	27.2
Baltic countries	0.45	0.05	51	7973	35.9
East Europe	0.52	0.16	43	6547	8.3
East Asia	0.36	0.5	19	882	4.1

Source: Transition Report 2000: Employment, Skills and Transition, EBRD, 2000

In evaluating the process of economic reform, it is essential to take into account these special characteristics and the problems that each country faced. At the same time, it should be noted that some of the features inherited from the Soviet Union also provided advantages for these countries. For instance, the raw materials focus of these transition countries in Asia provided advantages in the period when these economies were no longer closed. It was easier for countries producing raw materials to move from the CIS market to the world market. The estimated impact of moving from Soviet to world prices indicate large gains for Mongolia, Kazakhstan, Uzbekistan, and Turkmenistan, due to the fact that their natural resources such as gold, copper, gas, and oil were severely undervalued at Soviet prices, and also due to a rise in world prices for metals and cotton (Rumer 1996).

Alternative Approaches to Economic Reform

Mongolia and the Central Asian transition countries followed quite different strategies for the transition to a market economy, despite their similar initial conditions. Some moved more rapidly than others, and some had more coherent policies than others. In Mongolia, the reform programs were initiated by the government, which stayed in office until 1990. The economic reforms were motivated by the political and economic changes taking place in the Soviet Union during the mid-1980s, the growing realization that the USSR itself was facing serious economic difficulties and might not be in a position to help Mongolia, and the increasing domestic criticism that the centrally planned model received. The recognition of Mongolia by the United States in 1989 and the wide acceptance of the concepts of *perestroika* (restructuring) and *glasnost* improved the international environment for economic reforms (Asian Development Bank (ADB) 1992: 80–81).

In contrast, the Central Asian republics did not actively participate in serious discussions of different models of reform in the other parts of the Soviet Union. They oriented themselves toward greater economic integration with Russia, and hence were not fully prepared for economic independence and the dissolution of the Soviet Union.

That all changed in 1993, when the Central Asian transition countries were suddenly excluded from the ruble zone of the Russian Federation (Pomfret and Anderson 2003: 11). This exclusion, together with political independence, forced governments in this region to develop radical programs to stabilize their economies and to elaborate their own programs of reform and development.

In Mongolia, reforms in the period 1986–89 that were intended to create a new economic system had to wait until the introduction of a new political regime. After July 1990, when the coalition government was established after the first multiparty elections, the government moved rapidly in a wide range of areas with a view of converting the economy to a market economy. The transition strategy followed by Mongolia and many other transition countries in Eastern Europe and the CIS is known as the "big bang," or shock therapy approach. The main focus of the Government's economic reform program was the privatization of state-owned assets. Price liberalization was a second important element in transition. Selected retail prices were freed, a private banking system was created, and the national currency, the *tugrik*, was devalued. The result was rapid inflation, and the government was forced to increase wages and pensions. In the mid-1990s, an improvement in economic performance occurred; starting from 1994, GDP began to show positive rates of growth, and by 2000–01 real GDP had recovered to the level prior to the transition.

Kazakhstan first embarked on a transitional path of shock therapy, but later attempted to define its own special path. In particular, it tried to follow the development strategies adopted earlier by South Korea and Japan. As a result, in 1995–96, when the government made some corrections to its economic policy, state intervention in certain spheres of the economy increased. Although the country did get things underway quite swiftly with price liberalization and enterprise reform (Pomfret 2001). Unfortunately, policies promoting the privatization of energy and mineral rights were associated with widespread corruption. In 1996, Kazakhstan accepted currency convertibility on its current account, and prices since then have been determined by the market, and have been subject to world market forces (Pomfret 2001).

Kyrgyzstan initially delayed its economic reforms, but later adopted a policy of implementing the recommendations of the World Bank and the IMF, in other words, a policy close to "shock therapy". In Central Asia, Kyrgyzstan was the first country that managed to reduce hyperinflation, lowering the annual inflation rate to below 50% in 1995, a year earlier than Kazakhstan (Pomfret 2001). Complete price liberalization was achieved in 1994. Enterprise restructuring reform was more extensive than in any other Central Asian transition economy (Pomfret 1998). As noted by Gleason, the financial sector was also transformed, so that both the exchange rate and interest rates are market determined, although the financial market has limited allocative efficiency (Gleason 2003: 75–78). As noted by Pomfret (2001: 4): "In 1998, Kyrgyzstan became the first Soviet successor state to join the World Trade Organization, reflecting the country's liberal trade regime. Progress in creating the institutions needed to support a functioning market economy was, however, controversial. Important markets like those in foreign exchange, labor, and domestic capital did not function effectively." This may reflect not only economic conditions but also other factors such as shortage of human capital. Since independence, many of the educated Kyrgyz have emigrated to the developed countries.

Uzbekistan's economy is recognized as one of the least liberalized economies in the transition from central planning (Pomfret 2000). "Although the political regime is illiberal, the economy has been gradually reformed since independence. Price and enterprise reform proceeded slowly but by 1996 practically all prices had been liberalized along with housing and small state enterprises" (Pomfret 2001: 5). Trade policy was liberalized after export taxes were removed. Macroeconomic control was achieved slower than in Kyrgyzstan and Kazakhstan, the annual inflation rate only dropping below 50% in 1998. As noted by Pomfret (2001), compared with other countries, prices have been less free than in the other countries, and privatization has progressed more slowly. However, by 1998, the European Bank for Reconstruction and Development (EBRD) ranked Uzbekistan ahead of Kazakhstan in its annual index of cumulative progress towards establishing a market economy. Uzbekistan's government has, however, shown a willingness to reassess and change economic policies when faced with evidence that they are not working well, and in 2000–01 there were signs of increased support for private sector activities and liberalization of exchange controls (Pomfret 2000: 45).

Turkmenistan is classified as a slow reformer. The president made it clear that he wanted to transform Turkmenistan into the "Kuwait of Kara Kum." Moreover, his economic interests were oriented towards the West and East Asia, rather than towards Russia and the other countries of Central Asia. Initially, the president promised a variety of free utilities and services, the costs of which were to be covered for by natural gas export revenues (Pomfret 2001). However, the gas pipelines channeled gas only to former Soviet republics, and allowed little opportunity for market diversification. Due to a poor cotton harvest in 1996, Turkmenistan's GDP declined sharply, and as a result the country moved to more serious reforms (Pomfret 1999). The cost of daily consumer goods, for example meat, vegetable oil, tea, and sugar, were freed over time, and price subsidies were withdrawn (Pomfret 1999). Despite the promises of the president, there was still little evidence of change in the economic and social conditions in Turkmenistan (Gleason 2003: 105–108). In 1999, when the president declared himself President for Life, the EBRD withdrew all public-sector loans, "which underlined the increasing isolation of the country" (Pomfret 2001).

Tajikistan is acknowledged to have established itself as a market-based economy, but civil war in the 1990s delayed the implementation of consistent economic policies (Pomfret 2001). A huge decline in GDP per capita occurred in the first half of 1990s, even after the political situation was stabilized and peace negotiated. Investment declined due to political instability and the poor security situation, while economic activity was stifled by lack of unified control because separate agencies wanted to raise taxes and fees to increase revenue (Pomfret 2006). In 1995, the parliament adopted a program to guide reform through to 2000. This program aimed to liberalize international trade, except for that in aluminum, to privatize state assets, and to establish an open economy with favorable conditions for foreign investment and the development of export-oriented production.

Table 3. Selected indicators of transition

Country	Year transition began	Starting date of stabilization program	Average inflation 1989–2005	EBRD Average Transition Indicator 2005	WTO status	Currency convertibility
Mongolia	1990	Jul 90	50.4	2.89	Joined 1997	Yes
Kazakhstan	1992	Jan 94	216.6	2.93	WP 1996	Yes
Kyrgyzstan	1992	May 93	154.8	2.93	Joined 1998	Yes
Tajikistan	1992	Feb 95	648.2	2.37	WP 2001	Yes
Turkmenistan	1992		187.0	1.3	-	No
Uzbekistan	1992	Nov 94	231.1	2.1	WP1994	No

Note: the WTO dates signify the establishment of the Working Party agreements; this does not necessarily reflect the current stage of negotiation. Sources: first three columns, IMF 2006; fourth and other columns, EBRD 2005.

A summary of selected transition indicators or degree of economic liberalization is presented in Table 3. The table clearly shows that we can classify these countries into two different groups in terms of liberalization: Mongolia, Kazakhstan, and Kyrgyzstan belong to the more liberalized group, and Tajikistan, Turkmenistan, and Uzbekistan to the less liberalized group. Among these countries, Kazakhstan had the greatest degree of liberalization and the best quality of institutions, while Turkmenistan, Tajikistan, and Uzbekistan ranked among the worst-off of all transition countries. WTO status and national currency convertibility suggest that Tajikistan has substantial potential for better economic performance and transition, but must complete its liberalization and stabilization programs in order to reach a level of transition similar to that of Mongolia, Kazakhstan, and Kyrgyzstan.

Pomfret (2001) observes: "Economic performance is related to initial conditions and other exogenous forces, as well as to policies. Given the preexisting specialization in primary products, the national development strategies have been outward-oriented." Despite attempts to protect the domestic market, trade policies have been liberal (Pomfret 2001). Mongolia has already signed favored-nation agreements with Japan and the U.S. to enable exports to these markets at preferential tariff rates. However, Mongolia's access to seaports in the PRC and the former Soviet Union lay mainly through railways. The long distances that had to be traveled to reach international markets involved high transportation costs and long travel times, which in turn retarded Mongolian exports. Similarly, Turkmenistan and Kazakhstan, which had been expected to benefit from exports of natural gas, "found themselves tied to old Soviet pipelines for their oil and gas exports, and Turkmenistan had great difficulty in collecting payment" (Pomfret 2001). Uzbekistan, on the other hand, benefited from cotton and gold exports that could be transferred and sold for hard currency (Jeffries 2001: 355).

Capital flows and external assistance have differed between countries. Direct foreign investment has gone mostly to Mongolia and Kazakhstan, to the energy and mining sectors. Kyrgyzstan and Mongolia also benefited from World Bank and IMF assistance, while after 1997 Tajikistan became another major beneficiary of Western aid.

Regardless of the reform strategy, all countries had to assign the state an active role in carrying out reforms and regulating the economy during the transition. In other words, all required a strong government capable of supporting political and macroeconomic stability. The failure of reform in Russia was only partly due to the application of shock therapy (Rumer 2000: 96), and this statement is no less true of Mongolia, Kazakhstan, and Kyrgyzstan.

Comparative Macroeconomic Performance

The period of more than ten years since the transition began is long enough for some effects of different economic policies and strategies to be visible. Some countries have changed their policies, particularly Uzbekistan, where there have been several policy changes within their gradualist transition. Other factors such as world prices of primary products have also made it difficult to assess their economic performance. Finally, the external debt of countries like Mongolia, Kyrgyzstan, and Tajikistan has increased drastically, which has called into question the sustainability of recent economic performance. This section attempts to identify recent macroeconomic developments in all six countries; in doing so, emphasis is given to development in GDP, savings and investment, inflation, public finance, foreign trade, and foreign direct investment.

GDP and sectoral growth

The reforms have had a major impact on all of these economies, and all of them experienced a plummeting GDP during the first half of the 1990s (Pomfret 2001). Figure 1 indicates the contrasting time paths of real GDP in the six transition countries until 2005 (Pomfret 2001). Compared with other Central Asian transition economies, Mongolia's adjustment process has been relatively smooth. While Mongolia's output recovery moved more slowly than in the transition countries in East Asia, its growth performance during the transition was better than those of the Central Asian states, except for Uzbekistan. Between 1990 and 2001, Mongolia recorded only three years of output decline, compared with five to seven years in the Central Asian countries. Real GDP declined significantly during the period 1990–1995 in all the CIS economies, including the Central Asian countries.

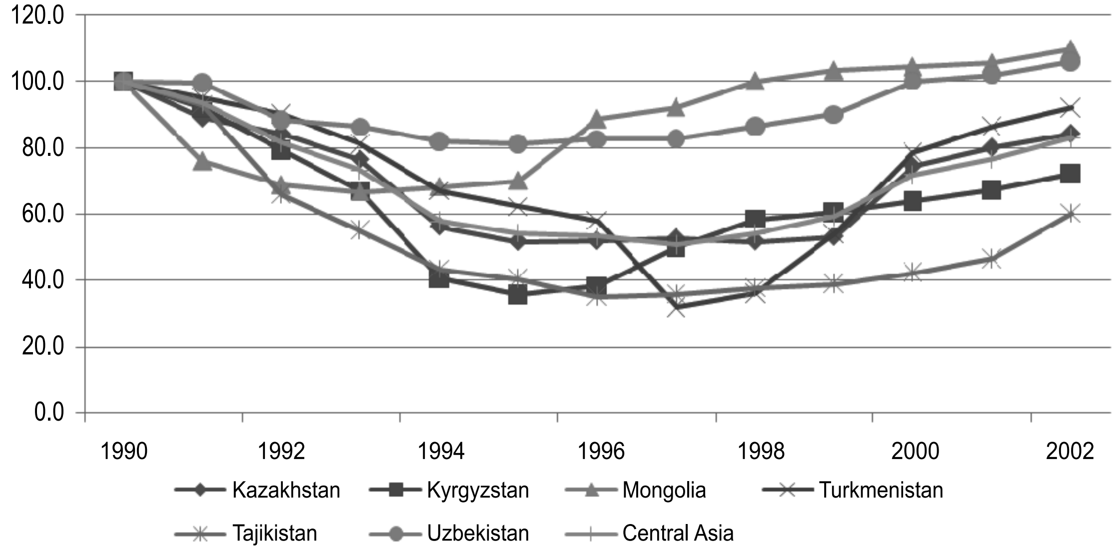
Among the Central Asian countries, Tajikistan experienced the worst GDP performance. The civil war destroyed economic activity until 1996, by which time real GDP had fallen by 40% from the level at independence. "With the impacts of the Russian crisis and of the civil war fading, the economy gradually benefited from greater stability: despite two consecutive years of drought in both 2000 and 2001, GDP grew by an estimated 8.3% in 2000, and 10.2% in 2001, compared with 3.7% in 1999" (UNESCAP 2003).

Kyrgyzstan suffered a real GDP decline of 45% during 1991–1995 due to external shocks that it was not well-prepared to face. Its economy grew by 15% in 1995–97, which was mainly due to one project, the Kumtor goldmine, which helped real GDP to increase during its investment stage. From 1998 to 2005, economic growth was slower than in the preceding period, and average annual growth ranged between 4% and 5%. Real GDP in all the Central Asian countries except Uzbekistan remained well below pre-transition levels. In 2002, it was down 39% in Tajikistan, 28% in Kyrgyzstan, 19% in Kazakhstan and 6% in Turkmenistan, compared with 1990 levels. In purchasing power parity terms, GDP levels in these countries (and in Uzbekistan) are comparable with African countries such as Tanzania and Ghana (Cukrowski 2006).

Turkmenistan's decline in real GDP was comparably slow in 1992–93. It accelerated in 1994–96, bottomed out in 1997, and then started to recover. At the beginning of the 2000s, Turkmenistan reported high GDP growth rates of 10%–20%. The reliability of the macroeconomic data officially reported by Uzbekistan and, especially, "Turkmenistan has been questioned by the international financial institutions, even though it is expected that the two large oil- and gas-exporting economies, Kazakhstan and Turkmenistan, have grown much faster than the rest of Central Asia since 1999. Growth in these two economies has mostly been driven by high energy export prices, foreign direct investment (FDI) and infrastructure investment" (Cukrowski 2006).

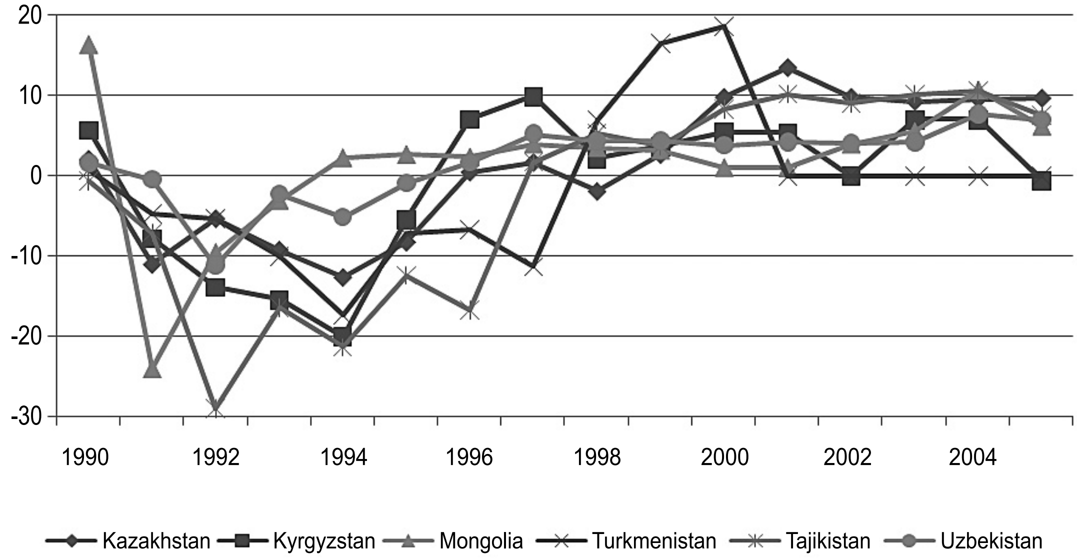
Kazakhstan's decline in real GDP in the first half of the 1990s was less than that in Kyrgyzstan, which may reflect the less radical reforms in the country. However, Kazakhstan did not enjoy the growth Kyrgyzstan had in 1996–97. Kazakhstan was badly affected by the Russian crisis in 1998, and the drastic increase in commodity prices, although output growth did return in 2000. According to the United Nations Economic and Social Commission for the Asia Pacific (UNESCAP 2003), the GDP increased by over 11% a year on average in 2000–2001 due to the positive impact of continued institutional and banking reforms and strong inflows of FDI. Strong economic performance was expected to continue in spite of the global downturn; in particular, GDP increased by 9.5% in 2002, compared with 2001 (UNESCAP 2003).

Figure 1. Comparative GDP performances, 1990–2002



Note: 1990 = 100. Source: World Development Indicators, World Bank, 2006.

Figure 2. Growth in real GDP 1990–2005



Note: Data for Turkmenistan and Uzbekistan are generated from national official statistics. Since 2001, these appear overstated. Alternative estimates place real annual GDP growth at around 8% for Turkmenistan and 1.5% or lower for Uzbekistan.
Source: World Development Indicators, World Bank, 2006; ADB, 2006.

Similarly, GDP in Uzbekistan started to increase. By the mid-1990s the country managed to arrest the GDP decline, and it experienced modest economic growth during the second half of the 1990s and beyond. The relatively good performance can be explained by the increase in the world price of cotton and gold, the goods that Uzbekistan exports to the international market. In all six countries, aggregate output was increasing by the late 1990s. In 2004, the regional GDP growth rate in Mongolia and Central Asia reached 10.6% and 7%, respectively, which was above average compared with all transition economies. This growth has led the way to reduction in poverty in these countries noted by the World Bank (World Bank 2006).

GDP aggregates during 1990–2005 are summarized in Table 4 and Figure 3. The main features of the structural transformation during this period may be summarized as follows.

The share of agriculture in Mongolia rapidly increased from 15.2% in 1990 to 43.8% in 1996 and then started to fall again, dropping to 21.7% in 2005. The rapid increase was mainly due to an increase in the number of livestock, and also the reduction in exports of meat and other animal products to the former Soviet Union. Kazakhstan experienced the highest decline in the share of agriculture in the GDP, from 34% to 6.5% in 2005. There has been a substantial decline in the production of grain, and in animal husbandry (with a sharp decline in the number of livestock). Agriculture faced a number of serious problems: a sharp fall in demand, competition from imported commodities (which were cheaper and of higher quality), a lack of working capital, and a small export market dominated by Russia. The other countries in Central Asia, where agriculture is the dominant sector of the economy, have experienced a smaller decline in the share of agriculture in the national income.

Table 4. GDP aggregates, 1990–2005 (%)

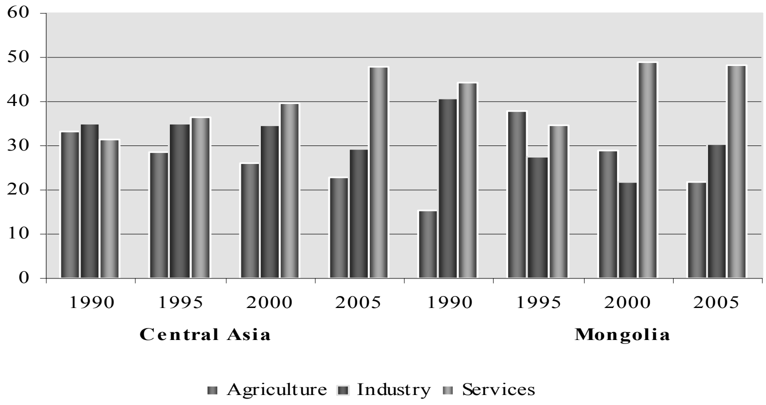
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Kazakhstan																
Agriculture	34.0	29.5	23.1	16.4	14.9	12.3	12.1	11.4	8.6	9.9	8.1	8.7	8.0	7.9	7.1	6.5
Industry	32.6	36.3	39.5	37.0	38.7	30.0	25.6	25.6	29.3	33.0	37.8	34.3	35.8	35.1	35.4	37.6
Services	33.4	34.2	37.4	46.6	46.4	57.7	62.3	63.0	62.1	57.1	54.1	57.0	56.2	57.1	57.5	55.9
Kyrgyzstan																
Agriculture	33.6	37.0	39.1	41.0	40.9	43.9	49.7	44.6	39.5	37.7	36.7	37.2	37.2	37.1	33.3	31.9
Industry	35.0	35.5	37.8	32.0	25.5	19.5	18.3	22.8	22.8	26.7	31.4	28.9	23.3	22.3	24.1	22.4
Services	31.4	27.6	23.1	27.0	33.7	36.6	32.0	32.6	37.7	35.6	31.9	33.8	39.5	40.6	42.6	45.7
Mongolia																
Agriculture	15.2	14.1	30.2	29.9	32.3	38.0	43.8	35.9	37.5	37.0	29.1	24.9	20.7	20.1	20.9	21.7
Industry	40.6	34.2	33.9	27.7	28.5	27.5	21.3	26.2	20.7	20.7	21.9	22.0	22.5	25.3	29.9	30.2
Services	44.2	51.7	35.9	42.3	39.3	34.5	34.9	37.9	41.8	42.3	49.0	53.1	56.8	54.6	49.2	48.1
Tajikistan																
Agriculture	32.9	36.3	27.1	23.3	24.0	38.4	39.0	35.4	27.1	27.4	27.4	26.1	24.7	27.0	21.6	24.2
Industry	37.0	37.0	45.4	46.4	40.8	39.0	30.6	27.4	25.9	29.2	38.5	39.8	39.0	37.2	35.0	25.9
Services	30.1	26.7	27.6	30.4	35.3	22.6	30.4	37.2	47.0	43.4	34.1	34.1	36.4	35.7	43.5	49.8
Turkmenistan																
Agriculture	33.3	36.6	27.4	18.0	32.5	16.1	12.6	20.0	25.2	24.8	22.9	23.5	22.5	23.5	21.6	24.0
Industry	37.6	36.9	46.1	57.0	44.9	58.6	64.7	44.3	40.6	43.6	41.8	42.7	39.6	42.3	35.4	31.3
Services	29.1	26.4	26.5	25.0	22.6	25.3	22.7	35.7	34.3	31.5	35.2	33.7	37.9	34.2	43.0	44.8
Uzbekistan																
Agriculture	32.9	37.2	35.1	30.7	37.5	32.4	26.2	32.3	31.3	33.5	34.4	34.0	34.5	33.1	31.1	28.1
Industry	33.2	36.6	35.8	34.5	26.4	27.8	30.5	26.1	26.2	24.3	23.1	22.6	22.2	23.5	25.2	28.7
Services	33.5	26.2	29.1	34.8	36.0	39.8	43.3	41.6	42.5	42.2	42.5	43.4	43.4	43.4	43.7	43.2

Source: World Development Indicators, World Bank, 2006; ADB, 2006.

Aggregated data for Central Asia indicates that during the transition, the share of agriculture in GDP decreased slightly, while the services share throughout the period generally rose. Industry somehow retained its position, and fluctuations in that sector of the market were smaller. The share of industry in Mongolia declined from 40.6% in 1990 to 21.3% in 1996, rising again to 30.2% in 2005. The initial decrease in industrial production can be explained by the fact that many state-owned factories closed their doors due to insufficient financing and management inexperience in dealing with the market. At the same time, the other Central Asian transition countries except Kazakhstan also suffered a decline in their share of industrial output.

The economic performance of a country is closely linked to its sectoral performance. For all the selected countries in this study except Kazakhstan, agricultural performance has mostly determined the pattern of economic development. In the agricultural sector for example, animal sub-sector performances played an important role in Mongolian economic development. Animal husbandry contributed more than 60% of agricultural sector output during 1990–1996, when the agricultural sector accounted for more than one-third of the GDP.

Figure 3. GDP aggregates: Mongolia and Central Asia, 1990–2005 (%)



Source: ADB 2006.

On the other hand, the industrial sector experienced 20% growth during 2002. This growth increased the industrial sector's share of GDP to 24.7%. The industrial sector grew by 11.9%, driven by its main components, namely mining and manufacturing, which grew 8.5% and 20%, respectively, and by construction, which expanded by 12.4%, reflecting the incipient real estate boom in Ulaanbaatar. The service sector, accounting for 45% of GDP, registered 10% growth due to the positive state of wholesale and retail trade, financial services development, and the transport and communications sectors (ADB 2002).

During this period, despite the growth of the industrial and service sectors, the agricultural sector's share of GDP declined dramatically due to the winters and springs of 1999–2002, which brought extreme climatic conditions (Consulate General of Mongolia in Singapore 2008). Massive numbers of livestock died in the droughts and snow falls that followed. In 1999, the total herd of 33.6 million heads of livestock declined to 26.1 million in 2001, and 23.9 million by 2002 (Consulate General of Mongolia in Singapore 2008). Consequently, agricultural production plummeted and economic growth slowed. However, real GDP grew from 1% in 2001 to 5.3% in 2003. This kind of economic growth was able to continue due to strong performances in the industrial and service sectors (Consulate General of Mongolia in Singapore 2008).

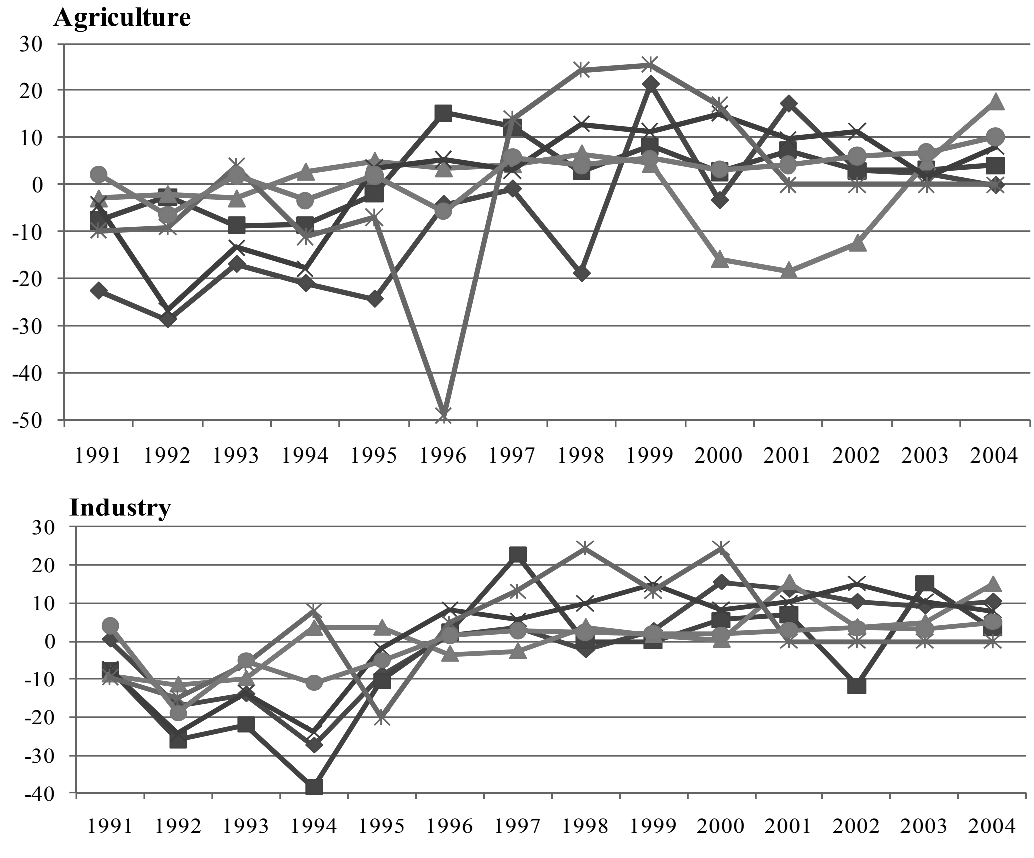
In the first half of the 1990s, all the newly independent states of the former USSR, including those in Central Asia, experienced a sharp decline. Between 1990 and 1995 the GDP fell by around 62% in Tajikistan, 49% in Kyrgyzstan, 39% in Kazakhstan, 30% in Turkmenistan and 18% in Uzbekistan. The decline in production was evident in every sector of the economy. During the same period, the output of agricultural goods fell by 11%–55% in these countries, and the drop in industrial output in this region was even more severe. Kyrgyzstan and Turkmenistan suffered the highest falls of 68% and 67%, respectively. Only Uzbekistan was able to maintain industrial production in the mid-1990s at the same level as in the previous five years (Zhukov 2002: 334). The economic recovery started to appear in the mid-1990s in Central Asia, and by the beginning of the 2000s most of the countries were in better shape.

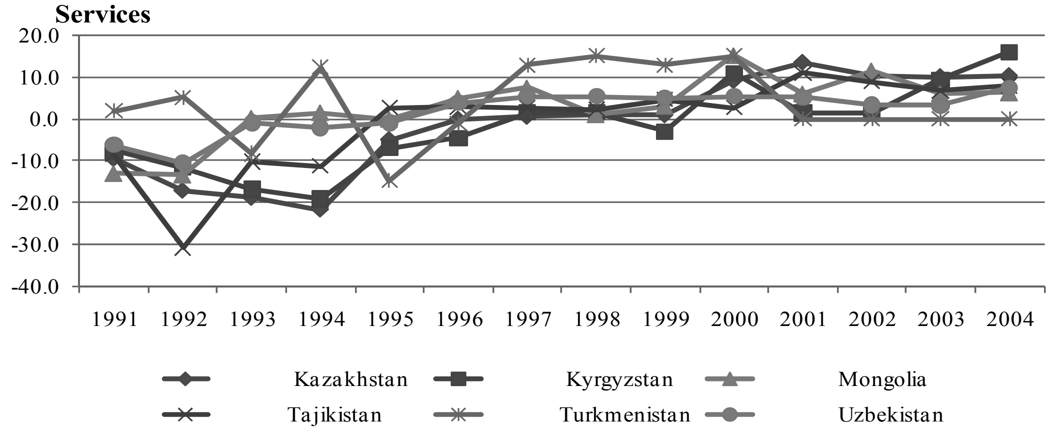
In Kazakhstan, agricultural output declined substantially with great annual variation in the early 1990s. Industrial sector output also declined during the same period. Iron ore and coal output declined by more than half between 1991 and 1999. Natural gas and electricity production also declined. However, while these declines were taking place, petroleum production increased substantially.

In the 2000s, both the industrial and agricultural sectors grew in terms of production. A good harvest of wheat for export helped the agricultural sector grow during this period. As noted by UNESCAP (2003), "Agricultural production grew by 3.0% in the beginning of 2000. Industrial output rose by almost 10% in Kazakhstan in 2002 as a result of rising oil and gas output." Agricultural output, which dropped immediately after independence, increased overall in the late 1990s, however industrial production also experienced steep declines at the beginning of the transition and, with the exception of the mining sector, has not recovered. The decline in the industrial sector has pushed many people out of their technical and professional positions. Most of the movement has been towards the service sector, which grew continuously during the transition period.

Agriculture is the dominant sector of the Kyrgyz economy, accounting for about 45% of GDP, half of the total employment, and 22% of exports in 1999. Agricultural production dropped in 1992, and then began to rise, although Kyrgyzstan showed a contraction in GDP at the beginning of the 2000s. "In fact, GDP declined marginally by 0.5% in 2002, largely due to a decline of more than 13% in industrial production. Economic growth was constrained by a slowdown in market-oriented reforms, industrial restructuring, and post-privatization reforms in the agricultural sector" (UNESCAP 2003).

Figure 4. The growth trends of GDP components, 1991–2004 (%)





Source: "World Development Indicators," World Bank, 2006.

In Tajikistan, both the industrial and agricultural sectors experienced growth during the period from 1998 to 2003. The industrial sector benefited from the continued growth of the aluminum sector. The aluminum sector had previously accounted for up to 60% of industrial production and more than 50% of total export income. In terms of the agricultural sector, output increased by 10.6% during the same time period. Despite the economic growth in Tajikistan during this time, the country had low levels of capital investment and large deficits in the external current accounts (UNESCAP 2003).

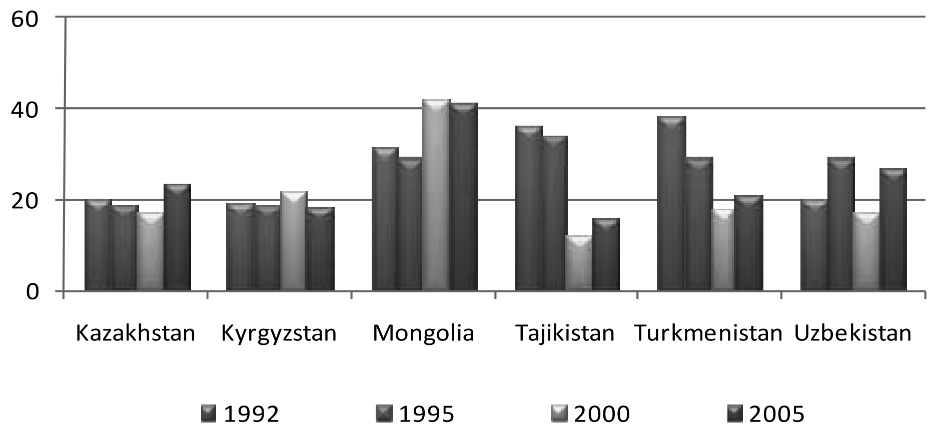
While agriculture is the largest employer in Turkmenistan, the country's energy sector is the largest revenue earner. The Turkmenistan government began concealing production figures for natural gas and oil in 1997, however international organizations suggest that actual output levels for gas production and other forms of industrial production in the latter part of the 1990s were considerably below the 1991 pre-transition levels. The GDP of Turkmenistan increased by 16% in the beginning of 2000. The main factor of economic growth in Turkmenistan was hydrocarbons, which received a significant inflow of state and foreign investment. The agricultural sector met its production targets, resulting in record gains for these years, while the cotton crop declined due to poor weather conditions (UNESCAP 2003).

Uzbekistan experienced steady economic growth during the early 2000s. This growth was driven by industrial production, which was approximately 16% higher than the 1995 time period, and agricultural output, which rose by 7% in the same period. At the same time, the service sector grew the fastest at 12.7% in the first half of 2002 (UNDP 2003).

Savings and investments

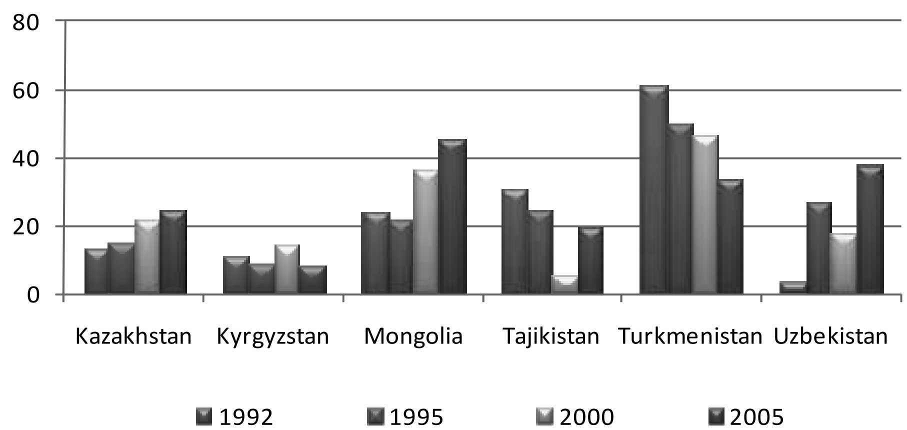
Domestic investment is a major contributor to the growth in output. If both Mongolia and the countries of Central Asia are to fulfill their growth targets for real GDP, they will need to maintain a substantial investment program. In Mongolia, the gross domestic investment as a proportion of GDP fell sharply in the immediate transition period. Prior to the transition, transfers from the USSR funded almost all investment, however these resources fell from 1989, and were eliminated in 1992. Investment stabilized in the early 1990s at around 25% of GDP. However, a high proportion of this investment was funded from abroad, while internal sources of domestic investment were very small. The gross domestic savings rate was probably under 20% of GDP, which meant that investment equivalent to between 5% and 10% of GDP had to be funded from abroad.

Figure 5. Gross domestic investments as proportion of GDP, 1992–2005 (%)



Source: World Development Indicators, World Bank, 2006

Figure 6. Gross domestic savings as a proportion of GDP, 1992–2005 (%)



Source: World Development Indicators, World Bank, 2006

Similarly, all the Central Asian countries experienced a decline in their gross domestic investment. In 1995, investment in Kazakhstan fell by 17% from the 1990 level. The level of capital accumulation was extremely low, and continued to fall. From the late 1990s, Kazakhstan enjoyed greater investment, with a 12% increase in the annual rate of capital investment. Kyrgyzstan experienced an unstable rate of investment and savings. It experienced a sharp decline in investment the first years of transition until 1995–1996, when the economy started to recover due to an increase in world prices for raw materials. The investment rate was high during this period, but then declined sharply again, until in 1998 investment amounted to around 30% of the level in 1990. The civil war, security concerns, and the overall unstable political situation were the main reasons for a very low level of investment in Tajikistan (UNESCAP 2003). In Uzbekistan, a relatively low level of domestic savings during the period 1992–2000 contained the expansion of domestic investment. Realizing the limited capacity of the private sector to attract investment in the early years of transition, the Uzbekistan government aimed to maintain a relatively high rate of state investment. The share of state investment during the period 1995–2003 fluctuated between 23% and 30% of total investment, 95%–97% of which went to state-owned enterprises.

Inflation

Centrally planned economies suffer from suppressed inflation and disguised unemployment. Under communism, prices are artificially set by central planners, rather than being determined by market forces of supply and demand. The sudden elimination of price controls caused dramatic rises in the cost of consumer goods as those goods moved to normal market prices; hence inflation appeared out of control, achieving levels of 100%, 200%, or 300% a year. Eventually, this subsided.

For example, inflation, which was almost nonexistent up until 1989, rose dramatically from 1991 to 1993 in Mongolia. The factors responsible for the price increases were the easing of price controls in 1991, the phased devaluation of the exchange rate, and the depreciation of the *togrog* due to the growth of an unofficial barter trade. There were shortages of food, clothing, and household goods, and these raised the prices of consumer goods. The inflation rate of 121.2% in 1991 jumped to 321% in 1992 before falling back to 49.3% in 1996. Prices continued their downward path in 1998. The consumer price index rose 6% during the calendar year of 1998, compared with 15% the previous year. According to the ADB, the inflation rate "fell to 8.0% by [the] end of 2000, but accelerated again in the first half of 2001 partly due to higher electricity tariffs and a decline in domestic meat supplies due to severe winter weather" (ADB 2001). Presently monetary policy in Mongolia is aimed at reducing inflation to about 8% by the end of 2008 (ADB 2001) (see Table 5).

During the transition period, hyperinflation took place all over Central Asia. In 1994, Kazakhstan experienced the highest inflation rate, although it stabilized in 1995. In 1995–1996, the expansion program delivered a good economic result. Kazakhstan's trading position, however, weakened when the Asian crisis shook commodity prices, forcing the price of oil down by nearly 40%. Inflation rose again in 1998, affected by the Russian financial collapse. Kazakhstan's high degree of dependence on oil, gas, and metal exports to Russia meant that the financial crisis in Russia had an immediate impact on Kazakhstan's economy.

Table 5. Inflation rate, 1990–2005 (%)

	Mongolia	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan
1990	321	4	3	6	6	4
1991	183	91	85	100	103	91
1992	145	1610	855	574	2773	712
1993	268	1760	1209	1207	1292	1079
1994	88	1877	280	221	952	1239
1995	47	176	45	346	706	371
1996	37	39	32	431	1174	82
1997	9	17	23	65	62	66
1998	7	7	10	66	18	39
1999	12	8	37	27	23	44
2000	6	13	19	23	10	47
2001	1	8	7	30	12	45
2002	5	6	2	21	9	45
2003	8	6	3	28	6	27
2004	4	7	4	17	6	16
2005	9	8	4	10		21

Source: World Development Indicators, World Bank, 2006

In response, Kazakhstan's government initially tightened fiscal policies in mid-1998 and succeeded in reducing the inflation rate to 8.5% a year later, and to around 6% in 2002. Despite the government's aim to bring inflation down to 4%, the inflation rate reached 8.4% in 2006 and 10.8% in 2008. In 2002, however, consumer prices went up by 5.9%, reflecting rising wages, large-scale hard-currency inflows and an amnesty for capital repatriation; the last two factors contributed to an expansion in the money supply, which served to fuel inflation in 2002 (Gleason 2003: 45). In the period 1993–95, inflation soared and was then brought under control in Kyrgyzstan. Like Kazakhstan, Kyrgyzstan also suffered from Asian flu and the Russian financial market collapse, and inflation rebounded, reaching nearly 40% in 1999. A tight monetary policy and domestic currency stability contributed to relatively low rates of inflation in Kyrgyzstan in the 2000s. In 2002, for example, consumer prices only rose by between 1% and 3%. This was a remarkable achievement, given their high rates of inflation in the late 1990s.

After 1991, Tajikistan's economy went through several periods of high inflation, caused by the civil war, huge budget deficits, and monetary policies, with consumer prices increasing by 20%–50% per month in some periods. As a result, the financial system of the country was devastated, and a large part of household savings was effectively wiped out. From the last quarter of 1997, budgetary and monetary discipline was restored with the help of the IMF and the World Bank, and domestic prices stabilized (Rosati 1999). At the end of 1998, the impact of the Russian crisis and the enforced devaluation of the Tajik ruble added some new inflationary tendencies, but the restrictive financial policies were maintained.

In Turkmenistan in 2003, high domestic fuel prices and a rise in public sector salaries produced a moderate increase in consumer prices. The government of Turkmenistan introduced rationing of basic goods and rice, butter, flour, and sugar at subsidized prices, while restricting the exports of these commodities. Relatively stable domestic food prices and government price controls have helped to keep inflation at a relatively stable level of 7%–9% in recent years. Consumer prices were expected to rise by 9% in 2002, a sharp decline from the level of 24% experienced in 1999 (Gleason 2003: 106).

Uzbekistan experienced high rates of inflation for several years following the transition, however inflation was on a downward trend by the middle of 2002, owing to a seasonal fall in food prices and an increase in the production of consumer goods. Higher pensions and public sector wages in Uzbekistan have, however, placed upward pressure on inflation.

Foreign trade

Although Mongolia and the republics of Central Asia obtained their political independence, in 1991–92 they still depended heavily on trade with the CMEA countries and the Soviet Union.

In 1989, as much as 90.3% of Mongolia's total exports were destined for CMEA countries, with 73.2% going to the USSR alone. Similarly, 92.5% of its imports were from CMEA countries, with the Soviet share as high as 82.7%. As for Central Asian countries, trade with the Soviet Union represented a high proportion of total trade (exports plus imports): 96% in Tajikistan, 91% in Kyrgyzstan, 89% in Kazakhstan, 85% in Uzbekistan, and 84% in Turkmenistan. This situation changed substantially during the transition period, with diversification in both the destinations of Mongolia's and Central Asia's exports and the sources of their imports. By 1995, Mongolia had established trade relations with 56 countries. Goods were exported to 44 countries and imported from 53, and the customers for Mongolian exports had changed substantially from pre-transition days. Of the total, 15.2% went to Eastern Europe, 24.5% to Western Europe, and 54.1% to Asian countries. With respect to imports, 54.8% came from Russia and Eastern European countries, 26.8% from East Asia, and the remainder from Western Europe and the U.S. Capital goods accounted for 80% of imports, and consumer goods only 20%. In the export basket, copper still dominates, making up slightly more than half of total exports, while cashmere, wool, leather, meat, and related products contribute another 15%. It should be noted that fluctuations in the prices of copper and cashmere on the world market have a major impact on export earnings of Mongolia. Gold exports, primarily from newly privatized mines, have also been increasing. Expanding gold exports improved the country's terms of trade in 1997 and limited the overall deficit to only $40 million, and in 2006 the country experienced a budget surplus for the first time since its transition. The Russian Federation is no longer a major importer of Mongolian goods, but China became an increasingly important trading partner during the transition period.

The collapse of the Soviet Union drove the Central Asian republics to seek access to world markets. This reorientation was even more necessary, since Central Asia could no longer rely on the delivery of critically important products from Russia and other former Soviet bloc countries.

Table 6. Export and import shares of GDP, 1995–1998

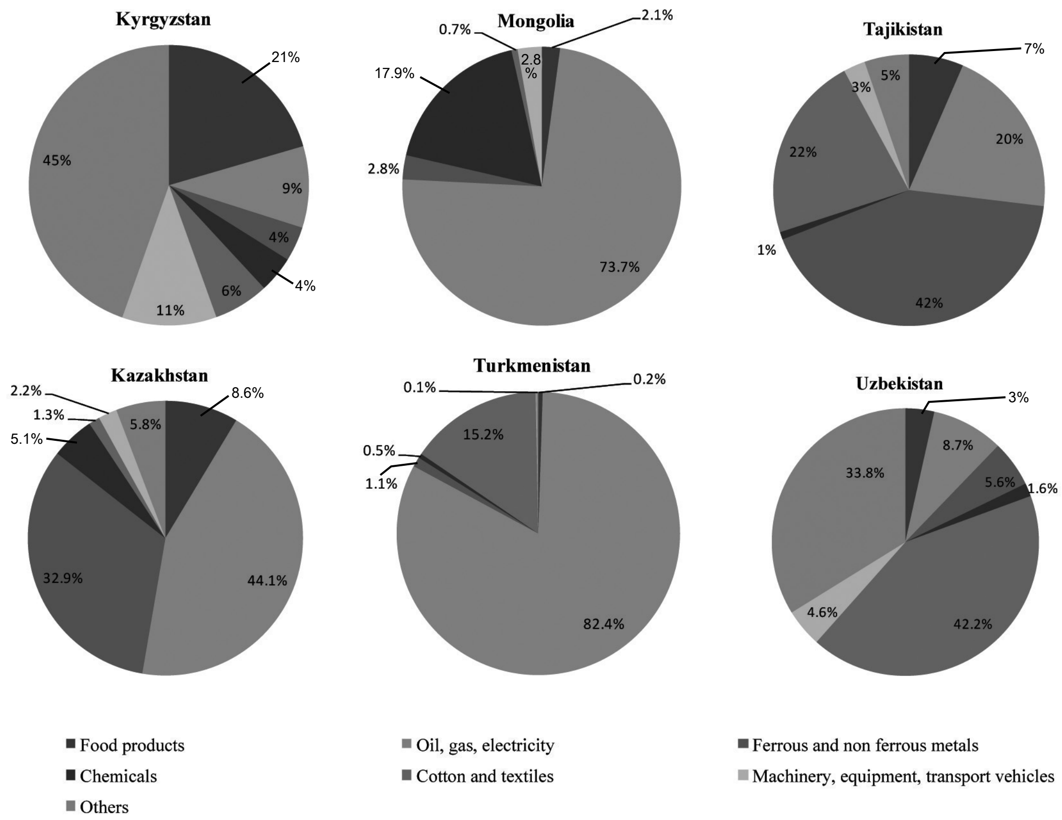
Country	Indicator	1992	1995	2000	2005
Mongolia	Export as % of GDP	34.2	40.5	65.2	70.8
	Import as % of GDP	41.8	48.5	82.0	75.1
Kazakhstan	Export as % of GDP	74.0	39.0	56.6	53.5
	Import as % of GDP	75.3	43.5	49.1	44.6
Kyrgyzstan	Export as % of GDP	35.6	29.5	41.8	38.3
	Import as % of GDP	47.6	42.4	47.6	56.8
Tajikistan	Export as % of GDP	9.7	63.5	84.3	53.9
	Import as % of GDP	12.5	68.2	86.3	72.8
Turkmenistan	Export as % of GDP	n/a	84.0	95.5	65.0
	Import as % of GDP	n/a	84.2	80.9	47.8
Uzbekistan	Export as % of GDP	27.0	27.9	24.6	37.9
	Import as % of GDP	43.2	28.1	21.5	28.7

Source: World Development Indicators, World Bank, 2006

Oil, natural gas, electric power, raw cotton and cotton fiber, ferrous and non-ferrous metals, gold, and uranium make up more than four-fifths of the region's aggregate exports (Kamolov 2001). For Kazakhstan, in 1998, oil, gas, and metals accounted for 77% of national export revenues, and 83.1% of its market was outside the CIS. In Kyrgyzstan, gold accounted for 50% of exports, and more than 70% of all exports were to markets outside the CIS. Kyrgyzstan's largest trading partner is Russia, which accounts for almost 40% of their foreign trade. After Russia come the Ukraine, the US, Uzbekistan, Turkey, the UK, Germany, South Korea, and other countries. Thus, the Russian financial crisis had a significant impact on Kyrgyzstan, and total external trade declined by about 25% in 1999.

For Tajikistan for the same period, aluminum, electric power, and cotton accounted for 84.7% of total exports, and 91.8% of all exports were to markets outside the CIS. Tajikistan's trade with the outside world was heavily affected by Uzbekistan government actions. When open conflict broke out in Tajikistan in 1992, Uzbekistan set up border controls. The Dushanbe–Tashkent railway line was closed in August 1992 to passenger traffic to prevent political refugees from moving out of Tajikistan. A short time afterwards, Uzbekistan closed the entire border between Uzbekistan and Tajikistan, completely cutting off Tajikistan from the outside world.

Figure 7. Composition of exports, 2002 (%)



Source: ADB 2006.

In the early 1990s, Turkmenistan's central government controlled its foreign trading partners, which were mostly the former republics of the Soviet Union, and it focused on exports of gas, fuel products, electricity, and cotton. Turkmenistan's policy on cotton exports was similar to the policy of the other Central Asian countries. This policy was to raise the price of cotton for trading with their neighboring countries, while lowering the price of cotton on the world market. "Since 1991, Central Asian countries have more than doubled their exports of cotton to countries outside the CIS, accounting for 70% of West European cotton import" (Curtis 1996).

In terms of importing, during the 1990s, Turkmenistan's main imports were food, light industrial products including textiles, and machinery. Similar to exporting, the main trading partners of Turkmenistan were still the former Soviet Union countries, with the exception of Finland, France, and Italy (Curtis 1996).

"Uzbekistan's foreign trade results largely depend on international gold and cotton prices. The CIS countries contribute nearly one-third to foreign trade. Uzbekistan's other principal trade partners are the U.S., South Korea, Germany, Japan, and Turkey. The country mainly imports capital goods, machinery and chemical products" (Egyptian Export Promotion Centre n.d). In Uzbekistan, cotton, gold, and uranium generated 76% of all exports and more than 90% of export revenue comes from markets outside the CIS. The de-industrialization of exports proceeded with particular speed in the largest states in Central Asia. Thus, in Kazakhstan, the proportion of machinery, equipment, and vehicles in aggregate exports fell from 5.1% in 1996 to 2.2% in 1998. In Uzbekistan, the proportion of machinery, equipment, and vehicles in exports to countries outside the CIS dropped from 2.0% in 1996 to just 0.4% in 2002.

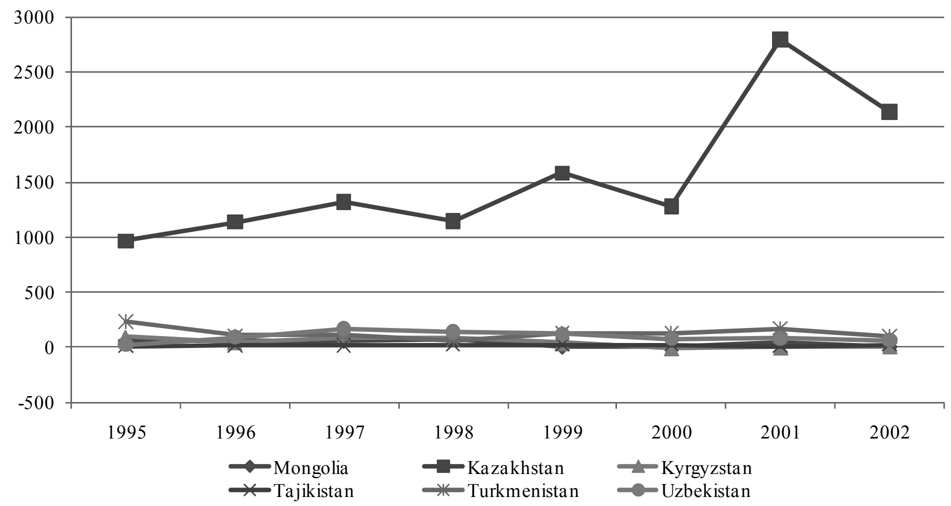
Foreign investment

Foreign factors are exerting a growing influence on the economic development of the Central Asian states, not only through trade, but also investment.

In Mongolia, prior to 1990, there was little to no private investment, with the majority of investment capital funded from the former USSR and allied countries. This fact changed in early 1990, with the passage of a variety of new legislation and trade agreements, all aimed at providing incentives for foreign investment in Mongolia. The year 1999 marked a turning point in moving Mongolia in a new direction, as it was granted normal trade relations status with the United States. As of July 2000, cumulative foreign investment in Mongolia reached $308.4 million, with more foreign investment expected in the future (Encyclopedia of Nations – Mongolia, online source).

In Kazakhstan, the government encouraged private, as well as foreign investment. In 1991, they adopted the Foreign Investment Law, which provided incentives for foreign investors, such as customs exemptions and security guarantees against law changes. "In 1996, foreign direct investment was estimated at $1.22 billion, and at $1.3 billion in 1997. From 1993 to 2001, the total gross inflow of FDI amounted to about $17 billion. Over a third (34% or $5.2 billion) of the FDI flow has come from the United States, with the United Kingdom as the second-largest source at $2.3 billion, or more than 15%. Other major sources of FDI are South Korea, China, Italy, Turkey, Japan, and Germany. As of October 2001, there were 3,606 joint ventures and 2,030 foreign companies operating in Kazakhstan" (Encyclopedia of Nations – Kazakhstan, online source).

Figure 8. Foreign direct investments, 1995–2002 (US$million, net)



Source: Data for Mongolia, Foreign Investment and Foreign Trade Agency of Mongolia (FIFTA) 2005; for Central Asian countries, EBRD 2003.

In Kyrgyzstan, foreign direct investment increased at a slow but steady rate during the period from the early to mid 1990s. The government passed various legislation, which promoted foreign investment in the country. A Foreign Investment Law was passed, which clarified foreign investors' rights, and established time frames for when foreign investment could occur. As a result of these actions, FDI increased, especially in the country's most valuable industry – gold mining. The biggest investment came from Canada, Turkey, the US, and China (Encyclopedia of Nations – Kyrgyzstan, online source).

In Tajikistan, although the government promoted foreign investment, outside factors inhibited most outside investment in the country. Among other things, including an ongoing Civil War, currency convertibility problems, and a prohibition on land ownership, few investments flowed into the country, with Russia providing most foreign investment (Encyclopedia of Nations – Tajikistan, online source).

A law on foreign investment and other legislation regarding private entrepreneurship passed since 1991 now provide most of the legal guarantees for foreign investors in Turkmenistan. In 1994, Turkmenistan's laws were modified to offer greater protection for the property and rights of foreign investors, and exemptions from duties and taxes for specific categories of investment. "Since 1991, Turkmenistan has received an estimated $2.86 billion in foreign direct investment" (EIU 2006) and for 2006 Turkmenistan expected to receive $308 million of FDI (EBRD 2006).

Unlike other countries, government intervention in Uzbekistan actually ended up discouraging foreign investment in the country. Although the economy seemed strong in the late 1990s, the government's actions, coupled with the country's lack of currency convertibility, reduced foreign investment to a low level. "By the end of 1992, 450 joint ventures were registered in the country but only 135 were actually operating" (Encyclopedia of Nations – Uzbekistan, online source). Despite the above setbacks, there were a few big investments in Uzbekistan. In 1994, British-American Tobacco, one of the world's largest cigarette manufacturers, announced a $200 million deal to acquire a majority stake in the state-owned Uztobacco (Encyclopedia of Nations – Uzbekistan, online source). In 1996, South Korea's Daewoo Group announced a multi-billion dollar deal to build a telecommunications network in Uzbekistan. The company also invested $658 million to produce automobiles in Uzbekistan (Encyclopedia of Nations – Uzbekistan, online source).

Comparative social sector performances

The social costs of the rapid transition from a centrally planned economy to a market-oriented economy in Mongolia and the Central Asian transition countries were very high. Basic social and human development services that had once been available either stopped functioning or became inaccessible to the majority of the population.

Unemployment

Unemployment is a relatively new phenomenon in Mongolia and Central Asian countries. With a centrally planned economy, Mongolia had not experienced unemployment before 1989. After 1990, significant levels of unemployment emerged. Real wages and the real value of pensions and social welfare benefits fell drastically. As a result, many families who had previously been secure fell below the poverty line. In 1994, the number of registered unemployed reached 76,000, or 8.5% of the economically active population. However it is estimated that only 20%–25% of Mongolia's unemployed actually register with the government, and unofficial unemployment is also thought to be high. Underemployment is also a problem. In the 2000s, however, unemployment has been decreasing, due to the rising number of jobs created by domestic and foreign investment.

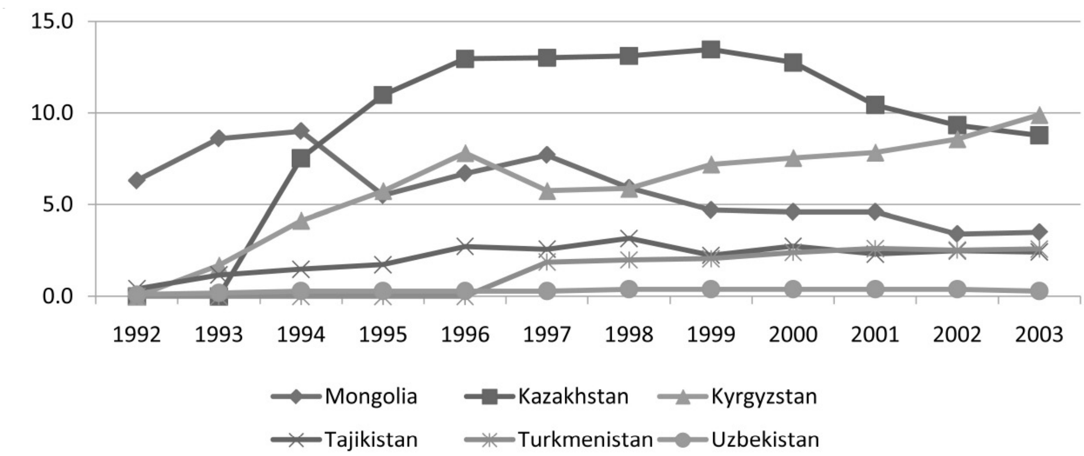
With the move towards a market economy, the structure of employment has changed in Kazakhstan. The biggest decline in employment has been in the agricultural and industrial sectors, while self-employment and employment in the small service sector (mainly trading) has grown, and continues to grow. Kazakhstan experienced the highest unemployment rate among the six transition countries. The highest level of recorded unemployment was 292,800 (4.6% of the workforce) at the end of February 2000, up by 13.4% from 246,000 (3.6%) a year earlier, and like Mongolia, the true level of unemployment in Kazakhstan probably exceeded the officially recorded figure. In 1999, the average monthly wage was 10,984 tenge (US$91). The ADB (2003) observes: "Living standards improved as continuing economic growth helped to raise real incomes by 4% from the year earlier level. In 2002, average monthly wages reached T20305 (equivalent to US$131). However, regional income inequality remained, with wages in oil-rich regions double the country-wide average wage".

In Kyrgyzstan, although the country experienced economic growth during the late 1990s, statistics show a steady increase in unemployment. "The unemployment rate increased from 1.7% of the labor force in 1993 to 5% in 2000" (ADB 2002). As the country moved into the new decade, some positive things did begin to take place. The incidence of poverty dropped, as a result of higher agricultural growth and stable food prices (ADB 2002).

As Tajikistan's transition was unsuccessful, because of many internal factors, unemployment remained high, as expected. Although the official statistics reported unemployment at just under 2%, the actual rate was estimated to be as high as 40%. As a result of the poor unemployment data, many well-educated Tajiks looked for job openings abroad due to better job availability and financial benefits (Bureau of Economic, Energy and Business Affairs (BEEBA) 2009). "Estimates of the number of labor migrants working outside Tajikistan at any given time range from 500,000 to as high as one million" (BEEBA 2009).

Since Turkmenistan officially guarantees employment to every citizen, there is no official unemployment in the country, and people registered as job seekers at labor exchanges are not formally considered unemployed. The number of such people remained unchanged at about 57,000 (2.6% of the labor force) in 2003. True unemployment is believed to be much higher, due to substantial hidden unemployment and under-reporting.

Figure 9. Unemployment annual growth rate (%)



Source: ADB 2006.

In Uzbekistan, the total number of unemployed as determined by the International Labor Organization (ILO) has tended to decrease, and the level of unemployment is reported to be the lowest in Central Asia, as well as of all the transition countries. In 2003, 439,500 people applied to job-placement bodies seeking jobs, a large decrease from 1995, and the number of officially registered unemployed in 2002 was 36,900, or 0.38% of the labor force. The official unemployment rate continued to mask hidden unemployment, however, as it did not include those who were unregistered, and actual unemployment remains high, especially in poorer regions.

Poverty

Official statistics indicated that poverty did not exist before Mongolia embarked on the transition to a market economy. However, poverty did indeed exist before and after the transition. After the transition, poverty was generated partly by external shocks and largely by the transition strategy as a consequence of the policies adopted to convert Mongolia from a centrally planned economy to a market economy (Griffin 1998: 27). For the Central Asian countries, with their initial relatively high incidence of poverty, the consequence of lower average income and increased inequality has been high poverty rates (Pomfret and Anderson 2003: 28). In Mongolia, poverty increased substantially after 1989, eventually reaching near-emergency levels, showing that poverty-stricken areas of the population were becoming worse off. This caused families to use up their remaining assets, further causing a breakdown in family and social support. “Defining poverty in terms of income, it has been estimated that in 1994, 26% of the total population (137,000 households or 587,000 people) lived below the minimum standard of living set by the Mongolian government, and 6% belonged to the group classified as very poor” (World Bank 1996).

Official statistics for the Central Asian countries show that 46% and 34.6% of the population of Kyrgyzstan and Kazakhstan, respectively, were defined as poor (with a per capita monthly income of less than $45) in the mid-1990s. The estimates of the Kazakhstan State Statistical Committee in 1999 showed that about 15% of the population had incomes less than the national minimum level in 1989. This figure rose to 54% in 1995, and to more than 80% in 1996.

Table 7. Poverty indicators, 2006

Country	GINI index	Population without sustainable access to an improved water source	Population living below $1 a day	Population living below $2 a day	Population living below the national poverty line
	1993–2003	1990–2004	1990–2003	1990–2003	1990–2003
Kazakhstan	34.0	14	2.0	16.0	34.6
Turkmenistan	38.1	28	..	..	..
Kyrgyzstan	41.5	23	2.0	21.6	47.6
Uzbekistan	46.8	18	..	..	27.5
Mongolia	32.5	38	27.0	74.9	35.6
Tajikistan	32.6	41	4.	42.8	..

Source: First column, “World Development Indicators,” World Bank 2006; columns 2–5, UNDP 2006.

In Uzbekistan and Turkmenistan, the situation was hardly any better than in Kyrgyzstan and Kazakhstan. In Tajikistan, by the late 1990s no less than 95% of the population was living in absolute poverty. In 1998, the average monthly wage was (according to official exchange rates) US$128 in Kazakhstan, US$56 in Uzbekistan, US$51 in Mongolia, US$39 in Kyrgyzstan and less than US$8.80 in Tajikistan. At the end of 1998, the highest average monthly salaries in Kyrgyzstan and Tajikistan belonged to people working in the sectors of finance and banking, where they earned about US$40; the lowest belonged to those in education (US$6), health care (US$4), and agriculture (US$2.5). The low absolute level of income led to a consumption structure that was transparently primitive. In Kazakhstan, households spent 51% of their aggregate income on food; the corresponding indicators were 55% in Kyrgyzstan, 58% in Mongolia, 62%–63% in Turkmenistan, 69% in Uzbekistan and 87% in Tajikistan. According to the UNDP (2006), about 74.9% of the population of Mongolia subsisted on less than US$2 a day in 2003. In Uzbekistan, as of 1997, half of the population lived below the official poverty line, defined as the equivalent of less than US$0.75 per day.

Table 8. Selected social indicators

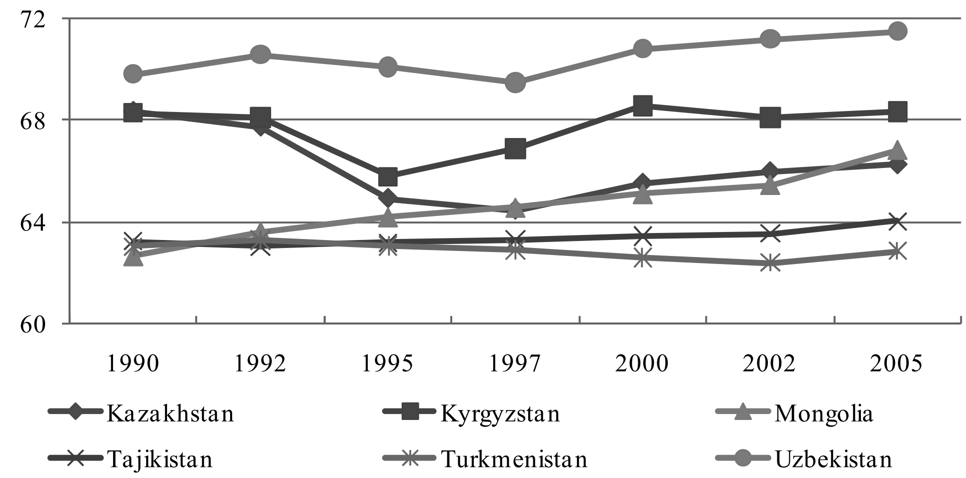
Country	Births attended by skilled health personnel	One-year-olds fully immunized	Children under height for age	Infant mortality rate	Under-five mortality rate
	(%)	(%)	% (under age 5)	(per 1,000 live births)	(per 1,000 live births)
Kazakhstan	99	69	13	42	82
Kyrgyzstan	96	69	28	46	96
Mongolia	97	96	n/a	39	49
Tajikistan	n/a	89	n/a	59	71
Turkmenistan	97	85	17	88	106
Uzbekistan	92	81	20	46	70
Low income	41	65	n/a	75	115
Lower middle income	85	85	13	31	40
Least-developed countries	36	72	35	93	148

Source: Data for Mongolia, Tajikistan and income levels, “World Development Indicators,” World Bank 2006; other countries, UNDP, 2005.

Although on average half the population was poor, 80% of the poor lived in rural areas. Evidence of the deterioration of the social situation also comes from such indicators as illness, child mortality, and life expectancy. A number of social indicators suggest that average living standards declined during the transition in Central Asia and Mongolia. Selected social indicators illustrate that the poverty level was highest in Turkmenistan, Kyrgyzstan, and Uzbekistan, and data for these social indicators for these countries are close to the averages for low-income countries. Although Kazakhstan fell into the group of middle-income countries according to the World Bank classification, these indicators also showed that income inequality remained a main problem there, since selected social indicators for Kazakhstan were much worse that for lower-middle-income countries.

Mongolia has the lowest infant mortality rate and the highest rate for immunization among all six transition countries, though poverty is still one of the obstacles to economic growth with 35.6% of the total population still living below the poverty line.

Figure 10. Life expectancy (age), 1990–2005



Source: Data for Uzbekistan – Statistical Yearbook of Uzbekistan, State Committee on Statistics of Uzbekistan 2006; data for other countries – World Development Indicators, World Bank 2006.

The data on life expectancy presented in Figure 8 also reflects this pattern. During the period 1989–1999, life expectancy declined by over two years in Kyrgyzstan and by almost four years in Kazakhstan. Life expectancy at birth for these countries was below the European average but above some of the East Asian countries such as Cambodia, Laos and Myanmar. Life expectancy was declining for Tajikistan, while for other countries it had been increasing, except for some years in the mid-1990s. As of 2006, the life expectancy at birth for men in Mongolia was 62.8 years, which is higher than the Central Asian average of 61.6 years. As reported by the United Nations Development Program (2006), females in these countries live 5 years longer than males on average (UNDP 2006).

The Human Development Index (HDI) estimated by the UNDP is calculated based on three dimensions: "living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and enrolment at the primary, secondary and tertiary levels) and having a decent standard of living (measured by purchasing power parity, PPP, income)" (UNDP 2002).

The best ranking for human development for the six transition countries is Kazakhstan at 79, followed by Turkmenistan at 105, while Kyrgyzstan, Uzbekistan and Mongolia ranked at 110, 113 and 116 in the world, respectively. All the countries experienced high adult literacy rates, and ranked highly on that measurement. As mentioned earlier, all the countries except Kazakhstan are classified as low-income countries by the World Bank, and the worst result was for Tajikistan, with a GDP per capita (based on purchasing power parity (PPP) figures) of $1202 PPP. This ranked Tajikistan 122 out of 177 countries based on available data (Table 9).

Table 9. Human development index

HDI value			Life expectancy at birth (years)			Adult literacy rate (% ages 15 and older)			Combined primary, secondary and tertiary gross enrolment			GDP per capita (PPP US$)		
Rank	Value	Country	Rank	Value	Country	Rank	Value	Country	Rank	Value	Country	Rank	Value	Country
1	0.965	Norway	1	82.2	Japan	1	100	Georgia	1	113.2	Australia	1	69961	Luxembourg
79	0.774	Kazakhstan	109	69.7	Uzbekistan	8	99.5	Kazakhstan	23	90.7	Kazakhstan	74	7440	Kazakhstan
105	0.724	Turkmenistan	112	67.1	Kyrgyzstan	9	99.5	Tajikistan	60	78.2	Kyrgyzstan	101	4584	Turkmenistan
110	0.705	Kyrgyzstan	116	64.5	Mongolia	15	98.8	Turkmenistan	61	77.3	Mongolia	130	2056	Mongolia
113	0.696	Uzbekistan	118	63.7	Tajikistan	17	98.7	Kyrgyzstan	80	73.8	Uzbekistan	138	1935	Kyrgyzstan
116	0.691	Mongolia	122	63.4	Kazakhstan	25	97.8	Mongolia	95	70.8	Tajikistan	141	1869	Uzbekistan
122	0.653	Tajikistan	128	62.5	Turkmenistan	128	19	Mali	172	21.5	Niger	152	1202	Tajikistan
177	0.311	Niger	177	31.3	Swaziland							172	561	Sierra Leone

Source: UNDP 2006.

Conclusion

Mongolia and five newly independent Central Asian states emerged from the Soviet bloc with similar economic systems and some similarity of economic structure. More than a decade later, their economic experiences are becoming very different from one another. The transition to a market economy in Mongolia has proved to be more difficult than originally planned. The poor economic performance can largely be explained by external shocks: the termination of Soviet aid, the return of macroeconomic advisors, the collapse of the Soviet trading bloc that consisted of the member countries of Council for Mutual Economic Assistance and, partially, by the failure of the implementation of reform policies. There were also serious problems in the privatization program and in monetary reforms. Where a large volume of credit was created and there was poor allocation of credit among enterprises and poor fiscal policy, government current expenditure rose sharply, which resulted in a large, inefficient public sector.

Similarly, Kazakhstan and Turkmenistan found it challenging to benefit from the change to world prices instead of undervalued Soviet prices. The former Soviet states, their previous export destination of choice, were now less accessible, and their bargaining power was weak. The poorest countries in Central Asia have done less well, economically. Although Kyrgyzstan adopted rapid and basic reforms, the country had difficulties in establishing a functional market economy. The impact of the rapid reform strategy was the severe decline in living standards, and the situation continued to worsen even when Kyrgyzstan began to experience positive economic growth. Tajikistan was the only country in Central Asia that experienced civil war, which badly affected its economic performance. Since 1997, when a peace agreement was reached, the government has adopted a reform strategy; however, implementation of this strategy continues to present many problems.

Uzbekistan, which was mostly characterized as a slow reformer, had the best economic performance, not only in Central Asia, but also of all the former USSR countries. Due to good governance, Uzbekistan experienced a lower rate of economic decline than the other countries in the early 1990s, and generated modest economic growth in the second half of the 1990s.

The common features of these six transition countries' economic experience have been severe transformational recession during the first half of the 1990s, followed by positive but slow growth since the late 1990s. In all six countries, governments had difficulty in mobilizing resources and meeting expenditure demand, often for social expenditures. As in all former Soviet economies in transition from central planning, inequality increased and, together with transformational recession, this created high levels of poverty in Central Asia and Mongolia.

Social indicators, which signaled great achievements during the era of the central planning system, worsened for all the selected countries. Unemployment increased substantially, particularly in rural areas, while many of the health-care services were removed from the list of services available to the public, despite the fact that health services were no longer free. The school enrollment ratio dropped everywhere in these countries, in both urban and rural areas, and the number of teachers was reduced, as many teachers moved to the private sector due to the low salaries available for teachers in the public system.

Obviously, initial conditions affected the success of the reforms; however, it is most likely that the reform strategy and the method of transition have played an important role in the success of these transition countries.

When will be transition be over?

Exactly when this type of transition will be completed is an area of controversy and is still being debated today. Just like in the case in which a recession is over, there is a disconnect between what economic theory provides as an answer and what economic reality suggests. As demonstrated in this study, in many instances the official statistics are misleading. The answer to this question hinges on this concept. A number of distinguished economists have argued about this issue and their definitions of the outcome of transition are widely different.

As cited by Svejnar (2002), Kornai argued that "the end of transition is a situation in which the communist parties have lost monopoly political power, the private sector accounts for the majority of GDP, and the market is the dominant coordinator of the country's economic activities." All our selected countries embarked on a radical shift in political power and a structural change in the economy and thus, according to this definition, transition must have been over at least by the end of the 1990s or the early 2000s (Brown 1999).

Unfortunately, the governments and citizens of these countries do not feel that they have completed their transition period, or that these countries' economies are functioning as pure market economies. They believe that the transition is the process that will make them partners with the relatively advanced countries of the world.

As noted by Brown (1999) "Gelb (1999) sees the end of transition as a state when the problems and the policy issues confronted by … 'transition countries' resemble those faced by other countries at similar levels of development." Such a definition is based on the economic development of the country, and therefore somehow comes close to reality (Brown 1999).

Personally, I believe that these countries are still in a transition period. The end of the transition only starts when these countries' economies replace a central planning system with a market system. All institutions must adapt and fully embrace the changes brought about by the switch to a market system. It is here that these countries can then generate sustainable economic and social growth that makes them compatible with advanced market economies.

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