



G8 Summit 2006

Issues and Instruments

St Petersburg, 15-17 July 2006

G8 Summit 2006



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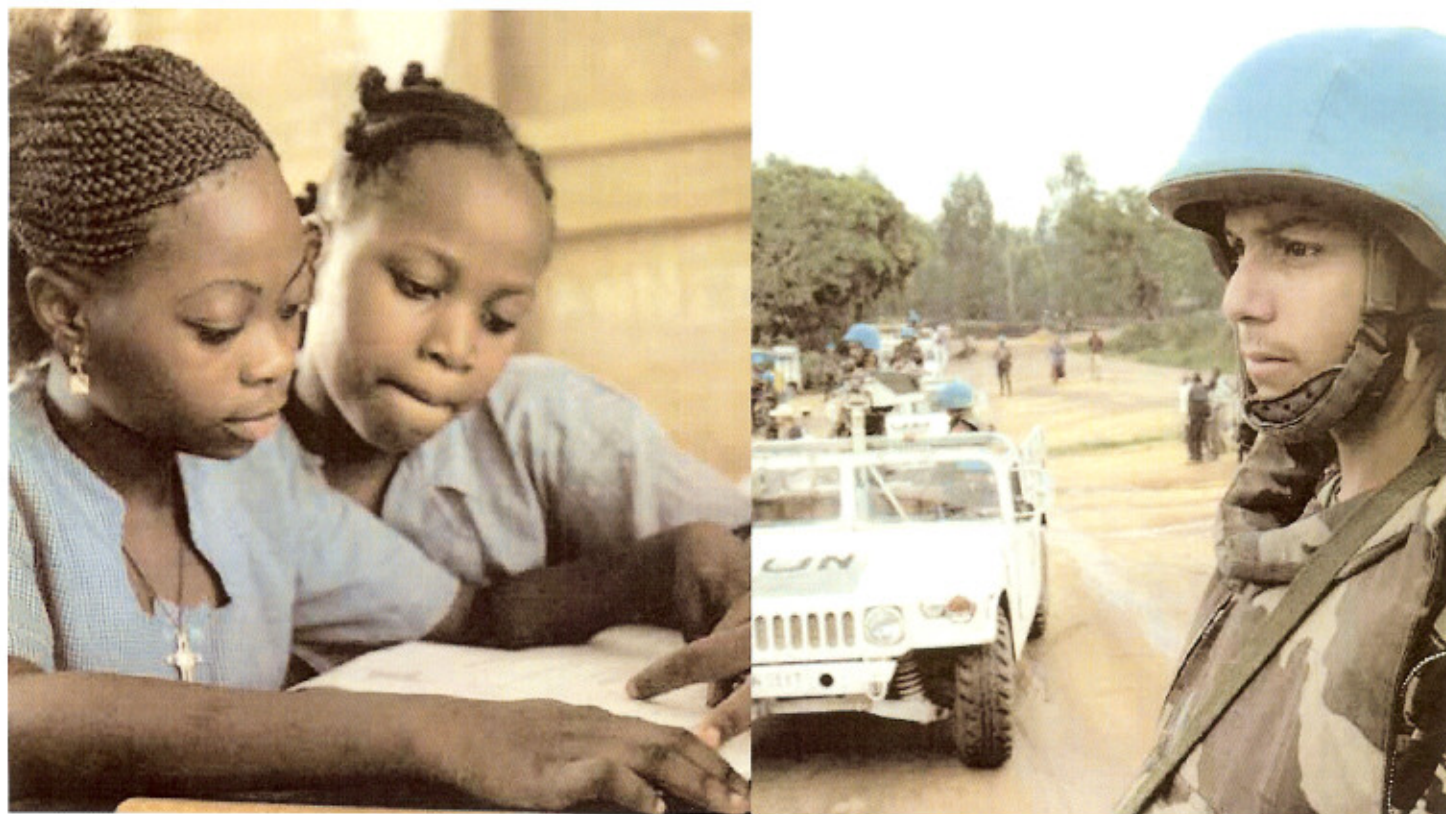
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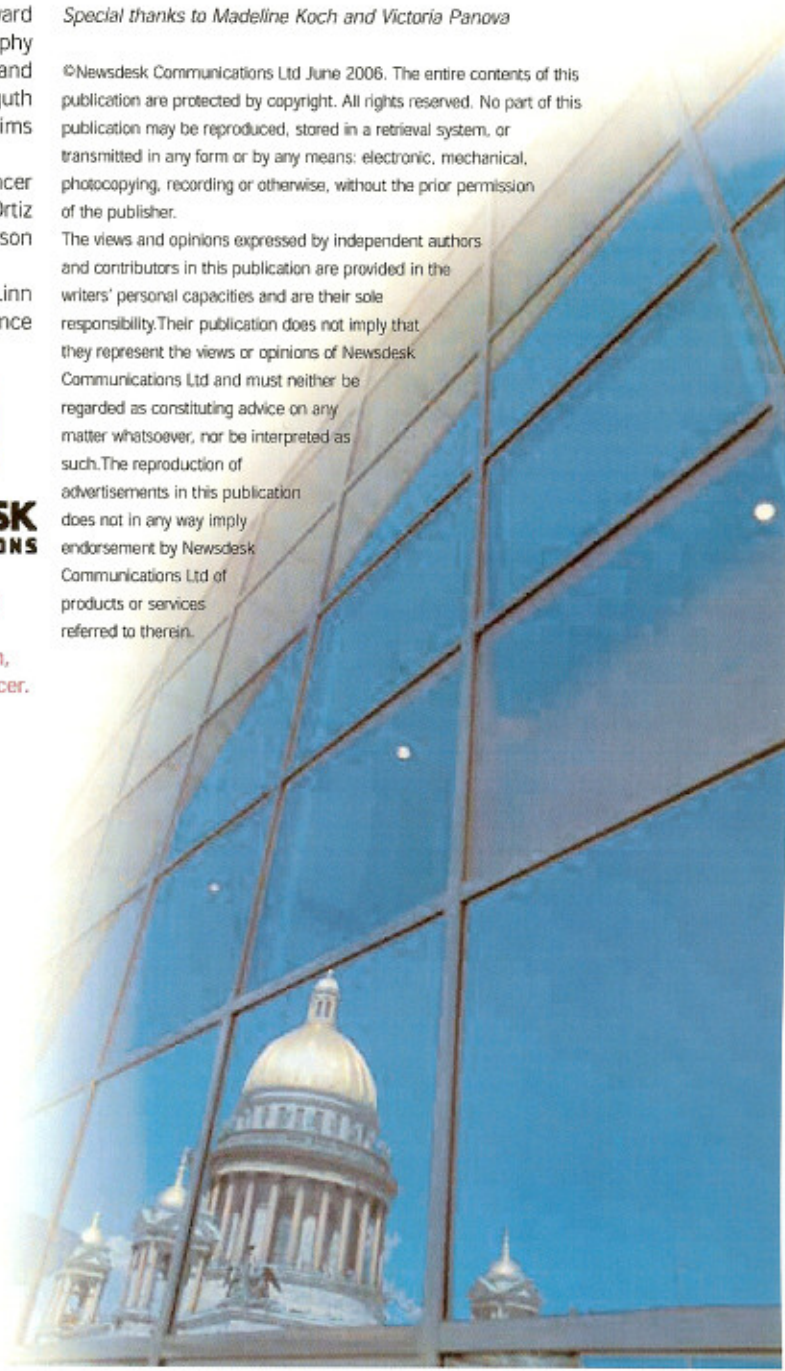
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Putting Central Asia back on the Silk Road

Mike Pfister, Division on Investment, Technology and Enterprise Development,
United Nations Conference on Trade and Development (UNCTAD)

Economic reform in the republics of Central Asia and China's
western provinces is opening up new investment opportunities

The Silk Road was the historic term for the transcontinental trade route between Europe and Asia that in 200 BC linked two great empires – the Roman Empire in the West and the Court of China in the East. The main route of the Silk Road connected Chang'an (modern day Xi'an) with Constantinople, and endured for several centuries. Today, the Silk Road Initiative aims to stimulate trade and investment in Central Asia under the leadership of the governments of China, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, thereby helping the region that was once sidelined by the march of history to reclaim its prosperity¹.

Since their independence from the Soviet Union in 1991, the Central Asian countries have witnessed a strong wave of privatisation and market-oriented reforms. The Silk Road region has emerged as one of the most dynamic regions in terms of growth, with a strong potential for investment. To reap the wide range of opportunities, a regional approach and commitment by the respective governments and the private sector through close partnerships is now needed.

The Silk Road region has emerged as one of the most dynamic regions in terms of growth, with a strong potential for investment

The economic backdrop improves

With the exception of China, the Silk Road comprises landlocked economies, with Uzbekistan being one of the two countries in the world being double land-locked, with none of its neighbours having access to the sea either. Yet these have all shown impressive growth figures. The region's gross domestic product (GDP) rose an impressive 10 per cent per annum in 2002-2004, from 6 per cent in 1997-2001. This becomes even more remarkable when these figures are benchmarked against the 5.2 per cent growth of all transition economies in 2002-2004².

Growth in the region goes hand in hand with the economic momentum in Russia, China, South Asia, and the positive signs in Afghanistan. The growth in the oil and gas exporting economies (Kazakhstan, Uzbekistan) has been fuelled by high oil prices, increased FDI,

investment projects in infrastructure and sound macroeconomic management³. The non-oil exporters have benefited greatly from the high gold and cotton prices and textile exports. These have been coupled with a flourishing manufacturing sector and a rise in manufactured exports. Not only did the heavy industry sectors boom, like in Kazakhstan, but the labour-intensive commodities in textiles and garments also witnessed upsurges⁴.

Table 1 displays some stylised facts about the Silk Road. The region consisted of 71 million people in 2003, generated a GDP of around US\$65 billion in 2000, and grew by an average 6.8 per cent per annum between 1999 and 2003. Thus, the Silk Road represents a large and growing market that is similar in population to that of Turkey, with about 10 million more people than the UK and France, and around 10 million fewer people than Germany.

Table 1: The aggregated five Silk Road countries, stylised facts, 1999-2003

	1999	2000	2001	2002	2003
The Silk Road region (a)					
Population, million people	68	69	70	71	71
--- Incl. whole China	1,304	1,313	1,323	1,332	1,340
GDP, billion US\$, constant prices	46	51	55	59	65
--- Incl. whole China	1,034	1,116	1,201	1,300	1,420
Real GDP growth, regional average	4.29	7.11	8.27	6.24	8.25
--- Incl. whole China	4.29	7.07	8.15	6.28	7.95
Real GDP per capita, regional average (b)	569	614	669	717	773

Source: UNCTAD calculations, based on World Bank, World Development Indicators Online, 2005; and China State Information Centre.

Note: (a) Including Kazakhstan, Kyrgyz Republic, Tajikistan, Uzbekistan and Xinjiang Province of China

(b) Including China as a whole

FDI trends

2004 saw a rebound in global FDI after three years of declining flows. At US\$648 billion, world FDI inflows were 2 per cent higher in 2004 than in 2003. More impressively, inflows to developing countries surged by 40 per cent. As a result, developing countries' share of world FDI inflows was 36 per cent, the highest level since 1997. The United States retained its position as the number one recipient of FDI, followed by the UK and China⁶.

Despite the surging FDI inflows in China, inflows are rather limited in the Silk Road region as a whole. For instance, with around US\$260 million of FDI in Xinjiang in 2004, the province accounted for only a fraction of China's US\$50 billion FDI inflows.

Only Kazakhstan was able to attract large amounts of FDI, up to US\$3.5 billion in 2004. From 1999 to 2003 FDI reached 9.3 per cent of GDP on average and contributed to just over 40 per cent of total gross fixed capital formation.

The major target sectors for FDI in the region are oil, energy, export-oriented manufacturing, agriculture and services, especially tourism. It is important to note that China plays an increasing role for the other Silk Road countries with their large market as an FDI origin. Also, the FDI potential indices for the Silk Road countries show positive improvements for China, Kazakhstan and Kyrgyzstan, thereby adding to the Silk Road's FDI attractiveness.

Prospects for growth and regional opportunities

According to the Asian Development Bank (ADB), economic growth in Central Asia will remain in the range of 9 per cent per annum for the next three years, backed by high projections for oil, gas and non-oil export commodities prices, global energy demand, and an expansion of the respective service sectors. In addition, China is expected to continue on a solid economic path of 8 per cent growth over the next decade⁸.

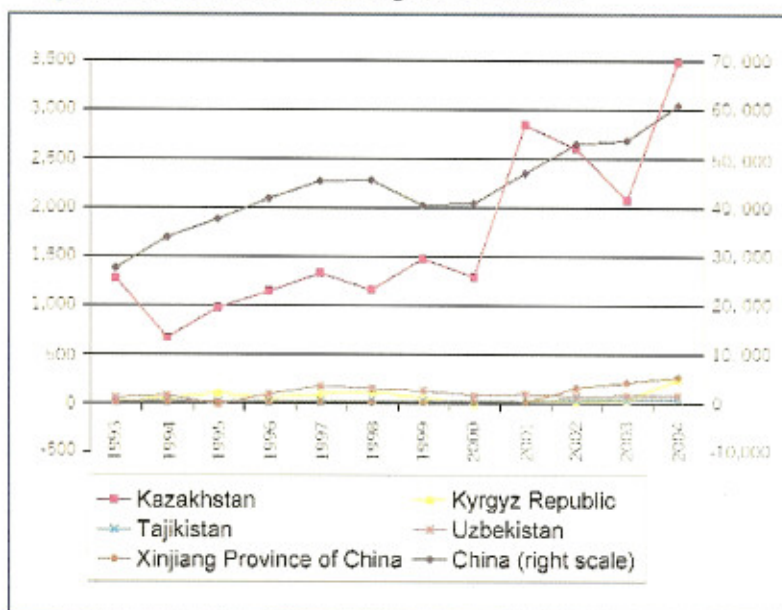
If the Silk Road countries remain committed to implementing policy reforms, elaborating market- and business-friendly strategies and especially to taking advantage of regional co-operation initiatives, such as the Silk Road Initiative, the following scenario looks realistic⁹.

Economic policy reforms initiated to date will accelerate in the region and a market economy will become more apparent. The trade regime, inter-regional as well as with the rest of the world, will remain a liberal one and there will be visible progress in large-scale privatisation, financial sector liberalisation and corporate governance. Export promotion strategies will be sharpened in the non-oil economies, along with the creation of relevant incentives and institutions. Furthermore, meaningful steps on interest rate liberalisation, reform of state-owned banks, and institutional development of capital markets will be expected. As privatisation progresses and business procedures are modernised and streamlined, a vibrant private sector will emerge.

Under this 'best scenario', a number of regional initiatives, such as the Silk Road Initiative and ADB's Central Asia Regional Economic Co-operation (CAREC) programme, will contribute to the coherent development of the Silk Road as a region, including in such areas as transport, trade and energy. Concrete

Economic growth in Central Asia will remain in the range of 9 per cent per annum for the next three years

Figure 1: FDI in the Silk Road region, 1993-2004





As privatisation progresses and business procedures are modernised and streamlined, a vibrant private sector will emerge

projects could include an integrated rail and road network system, harmonised customs codes, rationalised border procedures and the adoption of best practices in information and inspection systems. Institutional improvements will lead to a reduction of non-tariff barriers to regional trade and an efficient regional energy market will come about through tariff reforms and investments in regional energy infrastructure.

Regional economic diversification will be fed through a clear industrial competitiveness strategy. Predominantly, such a strategy would entail investment promotion and targeting, linkages between Silk Road enterprises with global transnational corporations, industry tailor-made investments in human capital, and restructuring of R&D and technology institutions.

This scenario will lead to Silk Road oil exporters benefiting from the regional co-operation initiatives and a regulatory environment that translates into integrated transportation networks and increased efficiency from price and tariff reforms. The non-oil exporting countries will benefit from industrial development as well as from enhanced regional co-operation. Based on these assumptions, the ADB predicts an average gain of about 20 per cent until 2015 resulting from greater regional co-operation, a strengthened policy framework, and moves towards a more competitive private sector environment. Currently, the Silk Road Initiative is preparing an investors' guide, which will provide deeper insights into regional business opportunities, as well as more sector-specific perspectives.

Overcoming the hurdles

With the exception of China, all the Silk Road countries are facing typical challenges of transition economies and emerging markets. Trade has yet to be used as a driving force for the region's economic development and is stifled by the imposition of complex tariff and non-tariff barriers, as alluded to earlier⁸.

Investment flows from abroad, with the notable exceptions of China and oil-rich Kazakhstan, have been weaker than expected. In addition, insufficient physical infrastructure, inadequate institutional capacity, and poor implementation of regional agreements are all factors that hinder economic integration.

The Silk Road countries are very diverse in socio-economic and political terms. One of the main challenges therefore is to help create capacity and mechanisms for efficient co-operation and integration in this region with shared historical ties, including a strong branding and marketing drive.

Regional initiatives should aim at presenting the Silk Road region as *one investment destination*, enabling concrete branding. To reconcile the interests of potential investors with the region's strong macroeconomic fundamentals, involved parties need to harmonise their legislation on foreign investment and their investment promotion efforts. To speed up the

The Silk Road Initiative (SRI): key facts

The SRI is a regional UN Development Programme (UNDP) initiative that aims to enhance co-operation and development among China*, Kazakhstan, Uzbekistan, Kyrgyzstan and Tajikistan. It focuses on facilitating public-private partnerships in three main areas: investment, trade and tourism.

The Initiative is launching sustainable capacity-building mechanisms, using the concept of 'seed money'. Through the establishment of regional mayors' and investment forums, a Silk Road city award, and the organisation of study tours for business communities, it supports the Silk Road countries in their efforts to reap the rewards from regional co-operation, and to further develop and prosper.

Goals:

- Improve policy and legal conditions for trade
- Initiate and attract investment
- Promote and attract tourism

Major Partners

- UN Conference on Trade and Development (UNCTAD)
- World Tourism Organization (UNWTO)
- Shanghai Cooperation Organization (SCO)
- BOAO Forum for Asia

For more information, please visit:
www.silkroad.undp.org.cn

* The SRI focus in China is on its western provinces of Xinjiang, Gansu, Ningxia and Shanxi

current process, a medium-term target for the establishment of common FDI legislation should be considered. There are concrete steps in this direction, such as the free trade area envisaged under the auspices of the Shanghai Cooperation Organization (SCO). As the process towards a free trade zone requires substantial legal harmonisation, the issue of convergence of the FDI framework could be incorporated into such negotiations.

Transparency is essential

Also needed are region-wide efforts to tackle the problem of *lack of transparency* in the investment process. To spread the harmonisation of existing laws across the region, special emphasis has to be placed on the harmonisation of *practices* to enforce those laws.

For instance, the publication of regional best practices combined with best practices awards could help to ensure success. Transparency issues should be included in the negotiation framework of any forum created for the Silk Road.

Each of the countries should clearly define its target sectors for FDI and make this information publicly available. Based on these national targets, the countries should formulate their regional targets, thereby facilitating regional branding as one investment destination. This common regional strategy has to be carefully coordinated to minimise competition in the attraction of FDI within the region.

Priority sectors

Based on the FDI trends presented earlier, three areas of focus could be envisaged: mining, oil and gas; petrochemicals; and power and energy – all interlinked sectors. This provides an excellent platform for a vision based on the region's competitive advantage.

Second, the transportation sector is deemed to be a promising element of the regional FDI strategy if the Silk Road is considered as one network from East Asia to Western Europe. Once this network is revived on a large scale, the Silk Road has the prospect to prosper from increasing transit transportation, as the old oasis towns did some 2,000 years ago.

Third, in the area of services, the tourism sector presents golden opportunities. With an abundant cultural heritage and sites along the ancient Silk Road, the prospect of branding the region as one single tourist destination is realistic. Within the context of the Silk Road Initiative, the World Tourism Organization (UNWTO) has jumpstarted a number of initiatives⁹.

A *persistent infrastructure deficit* within the region is a serious impediment to intra- and inter-regional trade. International organisations such as the ADB, UNESCAP and World Bank have sought to address this problem since the early 1990s with multi-million dollar pump-priming initiatives that have helped to create the conditions for attracting FDI. However, recent studies show that the infrastructure is still relatively poor, which poses a major impediment for trade and economic growth.

Next steps

There are three essential steps. First, a bundling of existing infrastructure projects could help pinpoint areas of immediate concern from a master plan perspective. In the long term, the master plan could more effectively channel funds to the most promising region-wide projects. Second, to offer a vision of promising returns for potential investors, the Silk Road should build on the legacy of the ancient Silk Road as a transport network connecting the prospering regions of Eastern China and Europe. Third, to attract FDI directly into transport infrastructure projects, innovative public-private partnership initiatives have to be created, such as toll roads and airport developments.

Branding and marketing the Silk Road

The branding strategy for the Silk Road should be based on five pillars: positioning, cohesiveness, momentum, opportunities and partnership. The Silk Road Investment Forum held in Xi'an, China, on 7-9 June 2006 encompassed these themes and was the first of a series of annual forums, which will allow concrete benchmarking of the various private and public sector commitments and policy efforts.

Mechanisms such as the Silk Road Investment Forum create a platform for joint strategy development, political mobilisation and commitment by all



The Silk Road should build on the legacy of the ancient Silk Road as a transport network connecting the prospering regions of Eastern China and Europe

participating authorities. This feature of cohesiveness is a key to success given the transnational nature of the region.

So the Silk Road is a region on the move – one that has to be tapped. Investors are attracted to such areas, and the region should aim at reinventing itself in a new forward-looking context, whilst building on tradition.

The brand strength of the Silk Road is rooted in the diversity rather than similarity of opportunities. The region covers four countries and four Chinese western provinces, thereby obviously presenting a wide array of investment opportunities. Close partnership between investors, host communities and the Silk Road governments themselves will seal the commitment to making the Silk Road an attractive investment destination¹⁰.

The Road ahead

The Silk Road is an investment destination strategically placed to service the new, partly untapped mass consumer markets of tomorrow in China, Central and Western Russia, India and the Middle East. The Silk Road Initiative lays the foundation for capacity building through a framework of both inter- and intra-regional co-operation among the five countries that will develop local markets, increase levels of FDI, stimulate cross-border trade and contribute to more equitable and balanced economic growth.

The Initiative presented here has a long-term expansion potential to include neighbouring nations such as Afghanistan, Pakistan, South Korea, Japan and Mongolia – which would eventually create a powerful trading bloc with considerable clout.

Endnotes

- ¹ Passow, Samuel, *op cit*.
- ² ADB, *Central Asia in 2015*, p.2
- ³ *Regional Cooperation Strategy and Program for Central Asia Regional Economic Cooperation (CAREC) Member Countries (Azerbaijan, Kazakhstan, Kyrgyz Republic, Mongolia, People's Republic of China, Tajikistan, Uzbekistan) 2005-2007*, p. i
- ⁴ *Central Asia in 2015*, p.2
- ⁵ *World Investment Report 2005* (UNCTAD), p.xix
- ⁶ ADB, *Central Asia in 2015*, p.7
- ⁷ Note: This scenario is based on *Central Asia in 2015* (ADB) p.9-11
- ⁸ Hübner, Wojciech, UNDP Silk Road Initiative, *Annual Progress Report*, p.2
- ⁹ UNWTO, *Tourism Pearls of the Silk Road*
- ¹⁰ Vokes, Clive *op cit*.

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