

# **EIB loans: eligibility of Central Asian countries granting a Community guarantee to the EIB against losses under loans and loan guarantees for projects outside the Community**

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This Commission Staff Working Paper is an annex to the proposal for a Council Decision on the eligibility of Central Asian countries under Council Decision 2006/1016/EC granting a Community guarantee to the European Investment Bank against losses under loans and loan guarantees for projects outside the Community. It provides background information on the economic situation of five Central Asian countries, namely Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, thus supporting the Commission's proposal for the establishment of the eligibility for European Investment Bank ("EIB") financing under Community guarantee in accordance with Council Decision 2006/1016/EC.

## **Kazakhstan:**

The Kazakh economy is increasingly driven by the hydrocarbon sector. In 2006, hydrocarbon activity (including transport and other related sectors) accounted for more than 30% of nominal GDP. About 30% of total government revenues were derived from the hydrocarbon sector, compared to 6% in 1999. The share of crude oil and natural gas output in industrial production has almost tripled since 1998, reaching 45%. Oil and gas exports accounted for over 55% of total export earnings. Investment in the hydrocarbon sector constituted about a third of total investment and one half of FDI. However, outside the petroleum sector, the business climate remains difficult, notably for small and medium-scale enterprises and foreign investors. A major impediment to private sector development is lack of transparency in law enforcement, customs and tax levy.

## **Kyrgyzstan:**

Following strong real GDP growth in 2004, the new government has managed to maintain political stability. Economic activity in 2005, however, slowed down following the political upheaval and output growth fell short of expectations. Real GDP in 2005 contracted slightly by 0.2%. In 2006, notwithstanding a serious accident in the Kumtor gold mine which limited its output by an estimated 40%, the real economy still rebounded with a GDP growth of 2.7%, mainly due to a recovery in agricultural output and manufacturing. For the year 2007 growth estimate is much higher, at 7.5%. Progress is lagging in a number of areas though. In particular, slow improvements in the business environment, insufficient regulatory and tax reform, and the still limited size of the financial sector continue to hamper entrepreneurship and investment. Key challenges are to improve tax administration, adopt concrete measures against corruption, enhance effectiveness of courts and reduce bureaucracy. Infrastructure is characterised by a generally low quality of services and inefficiency, requiring extensive investment which the public sector has been unable to upgrade due to fiscal constraints. The tax levels for companies are high and related procedures are burdensome.

## **Tajikistan:**

Tajikistan's GDP growth accelerated from 6.7% in 2005 to 7.0% in 2006 and to an estimated 7.5% in 2007, mainly due to major foreign-investment projects and strong domestic demand. Cotton and aluminium remain the traditional pillars of the economy. However, diversification of the economy

continued (though slowly), enlarging the share of the services sector, with trade, construction, communications and financial activities being the fastest growing sectors. The share of agriculture has declined between 1991 and 2005 from 36% of GDP to 22%. Domestic demand is driven essentially by higher private consumption spending, in turn mainly financed by strong growth in workers' remittances and, to a lesser degree, by public sector wage rises. Remittances are estimated in the 2006 balance of payments to have increased to about \$900 million, or about one-third of GDP. Tajikistan's business climate, however, continues to be difficult. Tajikistan ranks 158 out of 178 countries in the World Bank's Doing Business Report for 2008 and corruption remains an important obstacle, both to business and reform.

### **Turkmenistan:**

With large gas reserves and a small population, Turkmenistan's export potential is huge, though substantial investments are needed to increase production. Although its 4.5 million people receive free gas, electricity and water, incomes are among the lowest in Central Asia and health and education services are declining. The Government's economic policy is still determined by central planning. It continues to rely on production targets, mandatory state procurement, directed bank credits and foreign exchange restrictions. Key sectors of the economy, including the energy sector and the banking system, remain in state hands. The availability and accuracy of data and information continue to be major constraints in the analysis of economic developments in Turkmenistan. According to official statistics, real GDP growth in the last years was about 20%. The Turkmen authorities have recently expressed a willingness to engage more actively with international donors such as the World Bank (WB), and they have taken positive steps to address long-standing issues that hindered development of a WB program in Turkmenistan. The sustainability of the government's economic policies will depend mainly on its ability to earn hard currency from commodity exports. In view of the current development of the oil-refining, gas and cotton processing sectors, it seems likely that export revenue will hold up sufficiently to preclude the need for the government to make any progress towards introducing economic reform. The restrictive business environment will continue to deter most western foreign investors, dampening inflows of FDI.

### **Uzbekistan:**

Developments strongly suggest that the economy, despite the above-trend growth of the last three years, is underperforming relative to its potential, largely because of the reform backlog in structural policies. GDP grew by an average of 7.4% in 2005-2007, as compared to an average of 4.2% in 1999-2003. Agriculture's contribution was helped by a record cotton crop in 2005. Industrial performance has improved over the last, with significant contributions from machinery, chemicals, and metals, in good part based on larger export sales. Also noncommodity export recorded strong growth. In September 2007, the Government of Uzbekistan formally adopted its first Welfare Improvement Strategy (WIS), covering the period 2008-10, and transmitted the document to the World Bank (International Development Association - IDA) and the International Monetary Fund (IMF). The strategy accords a somewhat greater role to market principles and describes measures to undertake structural reforms. There is a particular emphasis on improving the business environment; it also provides a more candid assessment of economic and social challenges facing the country. Trade policy remains restrictive. Effective rates of protection against consumer imports are significant and excise tax rates on a wide range of consumer imports are higher than on domestic goods. Other regulatory "behind-the-border" barriers to trade include the regulation of wholesale and retail trade affecting the domestic marketing of imports. This regime imposes a heavy regulatory burden on individual entrepreneurs, in particular cross-border shuttle traders, who are an important source of supply for the private sector and contributes to the adverse investment environment. The poor business climate is reflected by the limited amount of FDI inflows estimated at \$ 200 million in 2005 (1.5% of GDP). Future FDI inflows however will be buoyed through hydrocarbons investments from the People's Republic of China and the Russian Federation.