3. Caucasus and Central Asia: Increased Risks Highlight Need for Reform

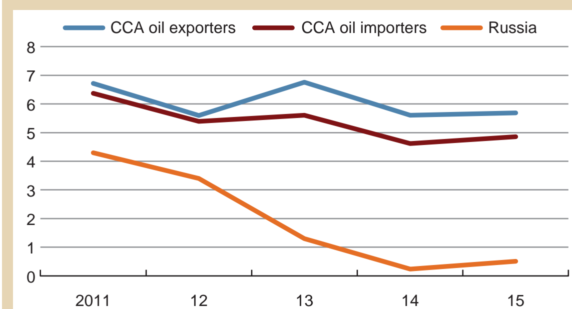
Economic growth in the Caucasus and Central Asia (CCA) is expected to decline from 6.6 percent in 2013 to about 5.5 percent in 2014–15. The forecast is ¾ percentage point weaker than in the May 2014 Regional Economic Outlook *Update, mainly because of negative spillovers from an economic slowdown and increased geopolitical risks in Russia and weaker domestic demand in a number of CCA countries. Inflation pressures are rising because of weakened exchange rates. Risks are tilted to the downside; in particular, a deeper or more protracted Russian slowdown could further weaken remittances, exports, and investment. Over the near term, countries should stand ready to tighten monetary policy if inflation pressures persist. A pause in fiscal consolidation is justifiable in some cases in response to weaker growth prospects. Medium-term policy priorities center on building credible anchors for monetary policy, introducing greater exchange rate flexibility to buffer against shocks, and growth- and equity-friendly fiscal consolidation to preserve debt sustainability and ensure intergenerational equity. Bold structural reforms that lead to better institutions, good governance, and vibrant business environments are necessary for the region to achieve an economic model that is sustainable, more inclusive, and diverse.*

Russia's Slowdown Is Weighing on CCA Economic Activity

Countries of the CCA region are expected to grow at about 5.5 percent in 2014–15, down from 6.6 percent last year (Figure 3.1), mainly because of weaker domestic demand in the region's oil exporters and weaker exports in the region's oil importers due to subdued economic activity in Russia, a key trading partner and source of remittances (Figure 3.2).

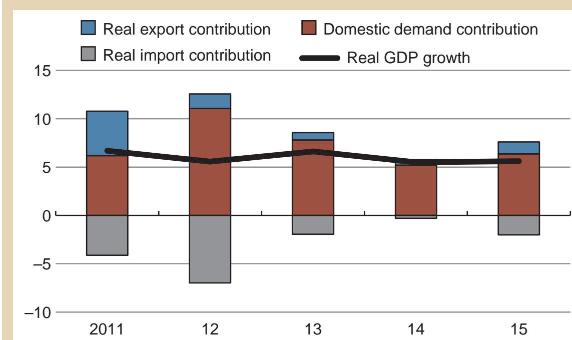
In the region's oil exporters, high oil prices, large policy buffers, and diversified export markets reduce the impact of Russia's slowdown. However, economic growth is still expected to soften from 6.8 percent in 2013 to about 5.6 percent in 2014–15. The reduction in oil exporters' growth mainly reflects further delays in the production of the Kashagan oil field in Kazakhstan and weaker domestic demand growth in Azerbaijan. Non-oil growth in oil exporters is projected to decline by about 1 percentage point to about 7¼ percent in 2014–15 on the back of slower consumer lending, following the implementation of macroprudential measures; increased investor

Figure 3.1
Real GDP Growth
(Annual percent change)



Sources: National authorities; and IMF staff calculations.

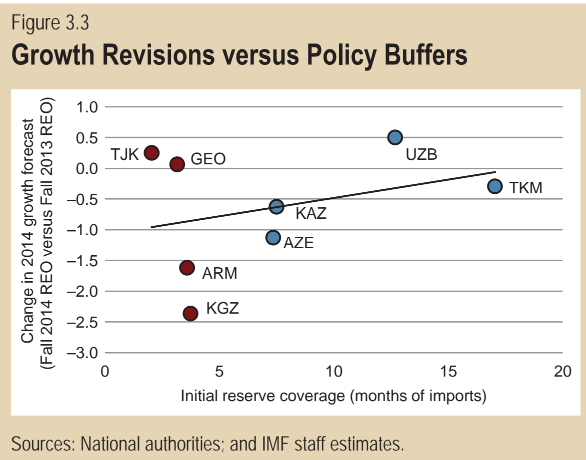
Figure 3.2
CCA: Real GDP Growth
(Annual percent change)



Sources: National authorities; and IMF staff estimates.

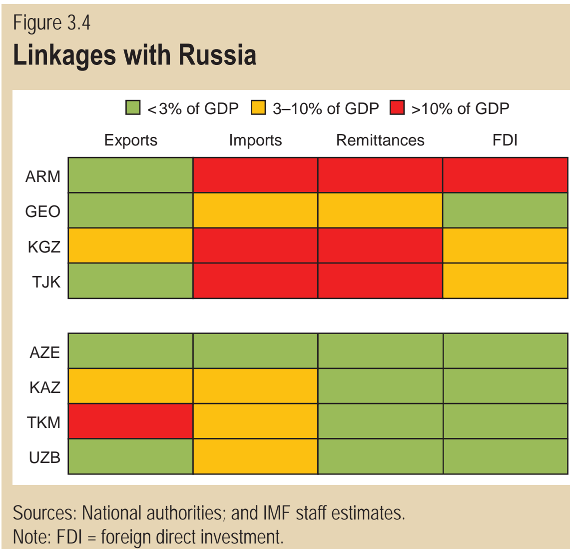
Prepared by Sami Ben Naceur and Amr Hosny, with research assistance by Greg Hadjian.

Figure 3.3
Growth Revisions versus Policy Buffers



Sources: National authorities; and IMF staff estimates.

Figure 3.4
Linkages with Russia



Sources: National authorities; and IMF staff estimates.
Note: FDI = foreign direct investment.

caution resulting from the devaluation of the tenge and other CCA currencies; and increased geopolitical risks surrounding the conflict between Russia and Ukraine.

In the region's oil importers, larger remittance and trade linkages with Russia, coupled with limited initial policy space, will reduce growth from 5.6 percent in 2013 to 4.6 percent in 2014, despite the expected recovery in Georgia (Figure 3.3). Growth is expected to pick up steadily in 2015 and beyond, supported by gradual fiscal consolidation and a reduction of external vulnerabilities. Armenia's favorable new five-year gas supply agreement with Russia and Gazprom, and large infrastructure projects in the Kyrgyz Republic, will also contribute to the recovery in the medium term.

Risks Are Largely to the Downside

External risks stem from an escalation of the Russia-Ukraine crisis and further tightening of sanctions against Russia, as well as from faster-than-expected increases in U.S. interest rates over the near term. Over a longer time horizon, lower potential growth and/or secular stagnation in advanced economies, and a protracted slowdown in emerging market economies, including a hard landing in China, are the key risks.

Geopolitical risks surrounding the Russia-Ukraine situation dominate the outlook. A deeper or more protracted Russian slowdown will have a significant impact on CCA economies through remittances (Armenia, Kyrgyz Republic, Tajikistan), trade (Kazakhstan, Kyrgyz Republic, Turkmenistan), and direct investment (Armenia, Kyrgyz Republic, Tajikistan) channels (Figure 3.4) (see also Box 3.1 for estimates of how Russia's slowdown could affect the CCA economies).

Risks of a protracted period of slower growth in advanced economies, including the possibility of deflation in the euro area and emerging market economies, especially the rebalancing of growth in China, could suppress exports and GDP growth in the CCA. Normalization of U.S. monetary policy might put pressure on domestic interest rates, but the effect is likely to be small, given the CCA's limited international financial linkages (see November 2013 *Regional Economic Outlook: Middle East and Central Asia* [REO] and May 2014 REO Update).

On the domestic front, the main risks stem from reversals or delays in growth-enhancing structural reforms (for example, Armenia, Azerbaijan, Kazakhstan, and Uzbekistan), particularly in market-sustaining reforms such as governance of enterprises and competitive institutions (Figure 3.5). In Armenia, the recent Eurobond issue and the gas agreement should mitigate the risk of rising financing pressures for the government and increasing energy costs, but risks associated with the implementation of improvements in the business environment remain.

Box 3.1

Growth Shocks in Russia: Implications for the CCA

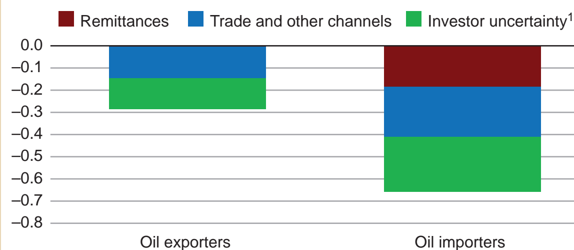
Growth in Russia significantly affects the economic prospects of neighboring countries, including those in the CCA, through a number of channels, particularly exports and remittances:

- IMF analytical work suggests that a 1 percentage point decrease in Russia's GDP would diminish CCA nonhydrocarbon exports by an estimated ¾ percent. Russian gas imports from Turkmenistan for domestic consumption could also be lower. CCA crude oil is exported to a global market and price impacts would be moderate.
- A 1 percentage point decrease in Russia's GDP would reduce remittances to the CCA countries by about 1½ percent. If the Russian ruble were to depreciate relative to that of a CCA country, the purchasing power of remittances could decrease further. This channel is especially important in the CCA oil importers, where remittances comprise a sizable share of national income (see Figure 3.4).

The impact of a slowdown in Russia's growth would be stronger in the CCA oil importers. The magnitude would depend on the nature of the slowdown, particularly whether it reflects a cyclical aggregate demand shock, increased investor uncertainty motivated by geopolitical tensions, or sluggish potential growth.

- A cyclical shock would call for monetary easing in countries with low inflation, and for allowing automatic fiscal stabilizers to operate, in most cases. However, substantial further fiscal stimulus would generally only be an option in the oil exporters, as was the case in 2008–09. This difference, together with stronger linkages to Russia, would make the impact of a negative aggregate demand shock in Russia more acute in the CCA oil importers than in the CCA oil exporters. Overall, IMF staff estimates that a temporary fall of 1 percentage point in Russia's GDP growth in a given year would lower growth in the CCA oil exporters by about 0.15 percentage points and in the CCA oil and gas importers by about 0.4 percentage points in that year (Figure 3.1.1).

Figure 3.1.1
Impact of 1 Percentage Point Fall in Russia's GDP Growth and Investor Uncertainty on CCA GDP Growth
(Percent)

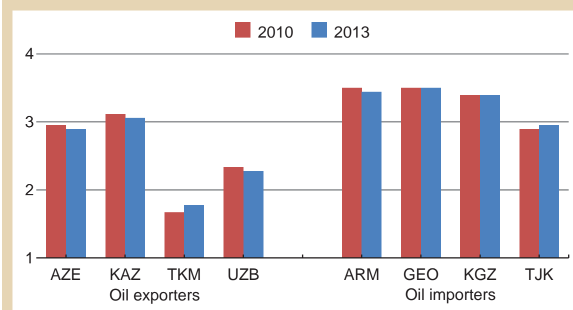


Sources: World Bank; and IMF staff calculations.
[1]Escalating geopolitical tensions raise risk premiums in Russia (by about 220 basis points) and other countries, including the CCA oil importers (by about 75 basis points) and CCA oil exporters (by about 45 basis points).

- If a slowdown in Russia were to be driven by elevated geopolitical tensions, additional investor uncertainty, not only about Russia but also countries located in close proximity, could lead to higher interest rates, lower investment, and weaker aggregate demand in the CCA. Confidence effects would be less acute in the CCA oil exporters because of their stronger macroeconomic positions and, possibly, increases in oil prices accompanying a rise in geopolitical tensions. These factors would amplify differences between the CCA oil exporters and importers in the size of the shock and the scope for a fiscal response. IMF staff estimates that, if a negative aggregate demand shock in Russia is accompanied by a decline in confidence and a rise in CCA risk premiums, growth could fall by about 0.3 percentage point and 0.7 percentage point in the CCA oil exporters and importers, respectively.
- If Russia's slowdown were to be structural and longer-lasting, the core transmission channels would be similar to those of the temporary demand shock, but the policy response would be different. In particular, countercyclical policy would be less appropriate because the shock would be persistent. Moreover, lower potential growth in Russia would mean that CCA growth—and hence tax revenues—would be lower than previously expected over the medium term, requiring a tighter medium-term fiscal stance.

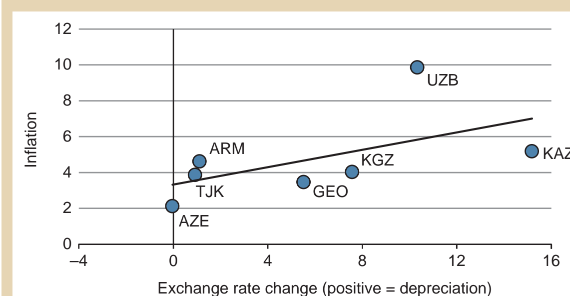
Prepared by Alberto Behar with inputs from Keiko Honjo and Ben Hunt.

Figure 3.5
Mixed Progress in Structural Reforms
(1 to 4+ scoring scale; higher is better)



Sources: Calculations based on European Bank for Reconstruction and Development Transition reports.

Figure 3.6
Inflation versus Nominal Exchange Rate Depreciation
(2012–13)



Sources: National authorities; and IMF staff calculations.

Table 3.1. Exchange Rate and Monetary Frameworks

	Monetary Policy Framework			
Exchange Rate Arrangement	**U.S. Dollar or Euro Anchor**	**Monetary Target**	**Inflation Targeting**	**Other**
Conventional Peg	Comoros, South Sudan, Turkmenistan, Venezuela			
Stabilized Arrangement	Kazakhstan, Macedonia, Vietnam[1]	Bangladesh,[1] Congo,[1] Tajikistan[1]		Angola,[1] Azerbaijan[1]
Crawl-like Arrangement	Croatia, Jamaica	China,[1] Uzbekistan[1]	Armenia, Dominican Republic[1]	Belarus
Other Managed Arrangement		Nigeria, Rwanda	Czech Republic	Kyrgyz Republic, Russia
Floating			Brazil, Georgia, Romania, South Africa, Turkey	India
Free-Floating			Chile, Mexico, Poland	

Sources: IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions;* and IMF country reports.
[1] These countries maintain a de facto exchange rate anchor to the U.S. dollar.

Inflation Pressures Call for Effective Monetary Policy Frameworks

Upward inflation pressures are expected throughout the region, with inflation projected to reach 6.4 percent in 2014, up from 6 percent in 2013, mainly because of nominal depreciations/devaluations and higher food prices in some countries (Figure 3.6), except in Armenia and Georgia, where inflation is expected to be below the central bank's target. The authorities should stand ready to tighten monetary policy if inflation pressures persist, especially in Kazakhstan. Countries of the region need to strengthen and modernize monetary policy frameworks and improve the monetary transmission mechanism. This will require enhancing monetary operations and liquidity management, as well as employing clear policy interest rate instruments, strengthening macroeconomic analysis and forecasting, and improving regular communication about policy direction.

In the CCA oil and gas exporters, inflation is expected to increase slightly to 6.5 percent in 2014, up from 6.3 percent in 2013. The February devaluation of the Khazakhstani tenge is expected to raise inflation, but will maintain it within the central bank's target range. Continued volatility in money markets, impaired balance sheets, and high financial dollarization may further complicate the conduct of monetary policy, especially in countries where exchange rates are used as an anchor or policy instrument, as in Kazakhstan and Turkmenistan. In most countries, moving toward more effective monetary and exchange rate frameworks would require the adoption of effective interest rate instruments, supported by open market operations and a gradual widening of the exchange rate band. As indicated in Table 3.1,

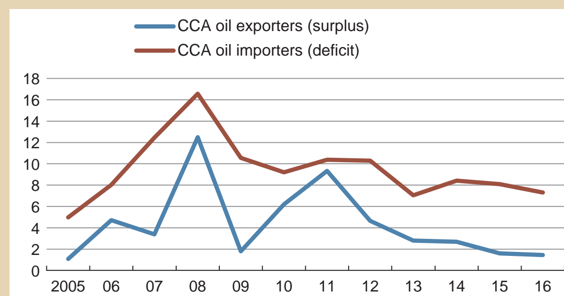
most CCA countries maintain pegged or managed exchange rate regimes, in contrast to many of their peers who have allowed greater exchange rate flexibility and, in some cases, have moved to inflation targeting. In Uzbekistan, continuous increases in administered prices and nominal depreciation mean that inflation will likely remain in the double digits, calling for tighter monetary policy and abstention from intervening in the foreign exchange market.

In the CCA oil importers, inflation is expected to accelerate from 3.6 percent in 2013 to about 5 percent in 2014–15. A weakening of the Russian ruble is putting pressure on the Kyrgyz and Tajik currencies, feeding quickly into inflation. In the Kyrgyz Republic, monetary policy is expected to remain tight, given pressures from the depreciation of trading partner currencies. In Tajikistan, the authorities should stand ready to tighten monetary policy, especially if high private credit growth persists. Monetary policy is appropriately accommodative in Armenia and Georgia, where inflation is still below the target for 2014.

Figure 3.7

Current Account Balances

(Percent of GDP)



Sources: National authorities; and IMF staff estimates.

External and Fiscal Positions Are Vulnerable

Weaker external demand is putting pressure on the external positions of most CCA countries. The current account surplus for the CCA region is projected to decline from 3.2 percent of GDP in 2012 to about 1.6 percent and 0.7 percent of GDP in 2014 and 2015, respectively, mainly driven by shrinking surpluses in the region's oil exporters (Figure 3.7).

For the CCA oil exporters, potential benefits from high oil and gas prices in 2014 are likely to be outweighed as weaker external demand, especially from Russia, puts pressure on current account balances. One exception is Kazakhstan, where a small improvement in the current account balance is expected from slower domestic demand growth and possible devaluation effects. External buffers remain large in most countries, owing to the accumulation of proceeds from commodity exports.

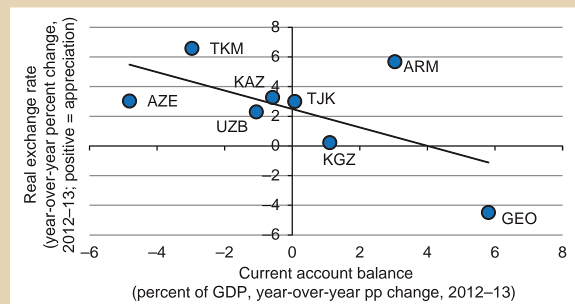
Lower remittances will worsen the external position of many oil importers, with the current account deficit expected to widen from 7 percent of GDP in 2013 to more than 8 percent of GDP in 2014–15. A rebound in imports, partly the effect of fiscal stimulus, and a weaker external environment are worsening Georgia's external balances. Higher food and lower gold prices, and an import-intensive public investment program will continue to create pressures on the external balance in the Kyrgyz Republic. In Tajikistan, remittance inflows and export earnings from aluminum and cotton are declining, while imports are still growing, leading to low reserve coverage. In Armenia, on the contrary, the current account deficit is expected to decline: remittances have remained resilient, and the new gas price agreement with Russia includes lower gas prices at the border. Greater exchange rate flexibility would help buffer shocks, stem pressures on reserves, and protect export competitiveness (Figure 3.8).

Overall, fiscal surpluses in the region's oil exporters are expected to continue to weaken from 3.4 percent of GDP in 2013 to 2.1 percent of GDP and 1.4 percent of GDP in 2014 and 2015, respectively (Figure 3.9). Moreover, fiscal breakeven oil prices are increasing, indicating higher fiscal risks. Most country authorities plan to gradually reduce the non-oil fiscal deficits over the medium term by containing expenditures and improving tax collection. Although the introduction of the medium-term budget

Figure 3.8

Real Exchange Rate versus Current Account Balance

(2012–13)

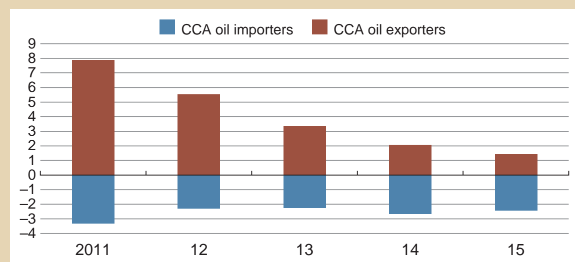


Sources: National authorities; and IMF staff calculations.

Figure 3.9

Fiscal Balances

(Percent of GDP)

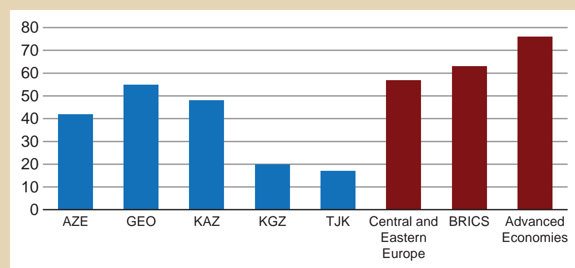


Sources: National authorities; and IMF staff estimates.

Figure 3.10

Fiscal Transparency Index[1]

(Index, latest available data; higher values are better)



Source: International Budget Partnership.

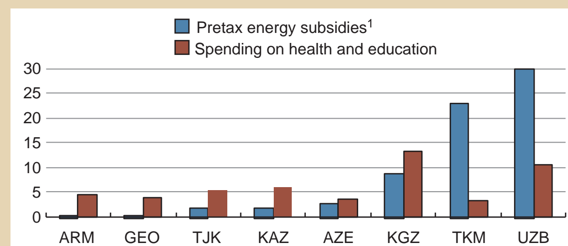
[1]Measures the extent to which governments provide the public access to budget information and allow for participation in the budget process at the national level.

frameworks and budget codes in Turkmenistan and Uzbekistan is welcome, fiscal frameworks in a number of oil exporters should be extended to properly cover extrabudgetary activities and reflect the true stance of fiscal policy (Figure 3.10).

Figure 3.11

Pretax Energy Subsidies and Spending on Health and Education

(Percent of GDP, latest available data)



Sources: *Deutsche Gesellschaft für Internationale Zusammenarbeit*; IMF, World Economic Outlook database; International Energy Agency; Organisation for Economic Co-operation and Development; national authorities; World Bank; and IMF staff estimates. For details on subsidy calculations, see Clements and others (2013).

[1]Includes petroleum, electricity, natural gas, and coal subsidies.

In the CCA oil importers, general government fiscal deficits are projected to worsen from 2.3 percent of GDP in 2013 to 2.7 percent of GDP in 2014, driven by modest fiscal stimulus in Armenia and Georgia—though challenges in overcoming budget underimplementation may jeopardize the fiscal impulse in the latter. The region's fiscal deficit is expected to improve slightly to 2.4 percent of GDP in 2015, reflecting lower deficits in Georgia and the Kyrgyz Republic (Figure 3.9).

In 2014, fiscal consolidation will continue in Azerbaijan, the Kyrgyz Republic, and Tajikistan, but will be delayed in Armenia, Georgia, and Kazakhstan. Although a pause in fiscal consolidation is justifiable in response to less favorable growth prospects in these countries, a return to gradual consolidation over the medium term is essential to build up buffers and place public debt on a declining path. In particular, streamlining nonpriority expenditures, effective targeting of social safety nets (in all countries), pension reform (in Azerbaijan and the Kyrgyz Republic), and scaling down energy subsidies (in Turkmenistan and Uzbekistan) can free resources for private sector expansion (Figure 3.11). Rebalancing the tax structure toward indirect taxes, and widening the revenue base by reducing tax incentives and exemptions, together with a supportive tax administration, can help create additional fiscal space. More efficient public investment, through better public procurement and continuous evaluation and

monitoring, can help boost growth and create jobs while preserving fiscal sustainability (Annex II).

Stronger Financial Systems Are Needed to Support Growth

Over the past two decades, the CCA countries have laid the foundations for a modern financial system, allowing financial intermediation in the region to improve considerably. Notwithstanding this progress, the financial system remains underdeveloped compared with those in many emerging markets. High dollarization is still a serious concern in the region, and can only be reduced with greater macroeconomic stability, sound monetary and exchange rate policies, and supportive prudential measures (Box 3.2). Other pressing issues vary across countries but often include the resolution of nonperforming loans (NPLs), curbing consumer lending, and curtailing directed lending.

Progress in dealing with these issues has been mixed. Enforcing NPL ceilings, increasing financing and coverage of the problem loan fund in Kazakhstan, stronger enforcement of provisioning rules in Kazakhstan and Tajikistan, and stricter requirements for the accurate classification of

Box 3.2

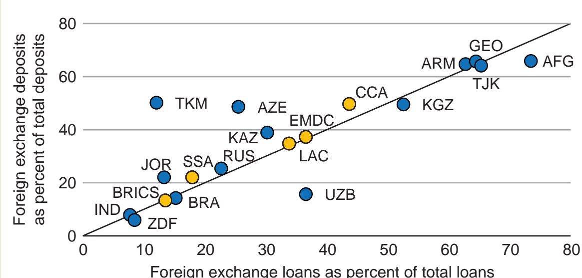
Reducing Financial Dollarization in the CCA

Financial dollarization in the CCA, among the highest in the world, is complicating the management of macroeconomic policy and increasing financial risks. The CCA countries have high levels of foreign exchange (FX) deposits and loans, compared with other emerging market economies (Figure 3.2.1).[1] Although dollarization in the region has declined since 2000, this trend reversed in the aftermath of the global financial crisis. A highly dollarized financial system can limit the effectiveness of monetary policy by weakening standard transmission mechanisms, and increase balance sheet and liquidity risks stemming from mismatches between U.S. dollar assets and liabilities in the private sector's balance sheet. High dollarization may also augment the impact of exchange rate changes on inflation, particularly in managed exchange rate regimes, which are in place in some CCA countries (Table 3.1). It also requires higher reserve cushions.

Figure 3.2.1

Dollarization in Selected Countries

(Latest year available)



Sources: Financial Services Institute; national authorities; and IMF staff calculations.
Note: BRICS = Brazil, Russia, India, China, South Africa; EMDC = emerging market and developing countries; LAC = Latin America and the Caribbean; SSA = sub-Saharan Africa.

An empirical study by IMF staff on the drivers of FX deposits and loans in the CCA, for the period 2001–14, finds that volatile inflation, currency depreciation, asymmetric exchange rate policy, and low financial depth have contributed significantly to financial dollarization in the region (Ben Naceur, Hosny, and Hadjian forthcoming). The study shows that frequent depreciations and high volatility of exchange rates are associated with a rise in FX deposits, while high inflation increases banks' lending in foreign currency. These results are broadly in line with the findings for other countries (see Neanidis and Savva 2009; Kokenyne, Ley, and Veyrune 2010). In contrast to experiences elsewhere, in the CCA, inflation volatility increases FX deposits and loans, and is a more important driver of dollarization than high inflation per se. The asymmetric nature of exchange rate policy in some CCA countries, which allows for depreciation but resists appreciation of the domestic currency, induces

Prepared by Sami Ben Naceur, Amr Hosny, and Greg Hadjian.

[1] The relatively low FX deposit ratio in Uzbekistan reflects the country's restrictive FX regulations.

Box 3.2 *(concluded)*

depositors to hold a higher share of FX deposits to preserve their purchasing power, to a greater extent than in other countries. Similar to the experience of dollarized economies in Latin America, high levels of FX deposits encourage banks to lend to domestic borrowers in foreign currency to maintain matched balance sheet positions. The study also finds that FX deposits and loans show strong persistence, and are higher, where there is less financial depth.

In light of these results, and building on successful dedollarization experiences in Latin America and emerging Europe, the CCA countries could consider a menu of macroeconomic and financial stability measures to reduce dollarization.

From a macroeconomic perspective, although there is no unique formula for success, credible monetary and exchange rate frameworks, low and stable inflation, and deeper domestic financial markets are essential ingredients of any dedollarization strategy. An inflation-targeting regime with flexible exchange rates and the absence of fiscal dominance would provide the best framework for market-driven financial dedollarization (Kokenyne, Ley, and Veyrune 2010). Proper sequencing of policies is also important. In countries with less flexible exchange rate regimes, a gradual widening of exchange rate bands, more efficient liquidity management, and effective policy rates could help improve the monetary transmission mechanism. More transparent and effective communication by central bank officials is also important to build public trust in the credibility of monetary policymaking.

IMF staff's empirical results also underline the importance of financial development for successful dedollarization. Introduction of local currency–denominated securities with credible indexation systems, development of markets for instruments to hedge currency risks, enhancement of nonbanking institutions and capital markets, improvement of credit information systems, strengthening of supervision, removal of administrative controls on interest rates, and introduction of unbiased taxation on income earned from FX deposits, bonds, or other financial transactions versus local currency taxes are measures that can help discourage dollarization.

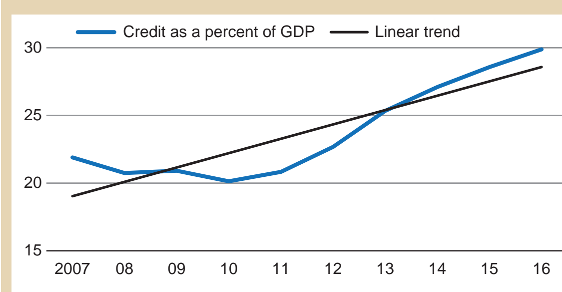
Successful dedollarization takes time. Over the short term, countries can focus on measures that make the local currency more attractive and reduce the asymmetry of exchange rate policy. Initiatives that have been successful in other countries include holding reserve requirements for FX deposits in local currency, imposing higher reserve requirements on FX deposits, remunerating the reserve requirement on local currency deposits at a higher rate than for FX deposits, raising insurance premiums on FX deposits, limiting FX lending to unhedged borrowers, and requiring banks to carry routine evaluations of currency risks.[2] When implementing these measures, policymakers need to account for risks from potential financial disintermediation and instability, and/or capital flight.

[2] See Cayazzo and others (2006), Rennhack and Nozaki (2006), Kokenyne, Ley, and Veyrune (2010), and García-Escribano and Sosa (2011) for summaries of successful dedollarization experiences in Latin America and emerging Europe.

NPLs in Azerbaijan and Kazakhstan are still needed. Azerbaijan and Kazakhstan have put in place measures to curb strong growth in consumer lending, but progress in controlling and reducing directed lending in Azerbaijan and Turkmenistan has been slow (Figure 3.12).

To ensure resilience and financial stability as markets develop and financial access expands, it is important for CCA countries to strengthen prudential regulation and supervision, and enhance corporate governance and risk management. Specifically, the region's

Figure 3.12
Credit to GDP versus Trend



Sources: National authorities; and IMF staff calculations.

underdeveloped banking sector requires stronger regulatory frameworks, faster progress in restructuring state-owned banks, and measures to improve financial access, strengthen competition, and boost credit markets (Annex III).

Time for a New Economic Model

Despite two decades of strong economic performance, poverty and inequality rates remain high in the CCA. Emigration and unemployment, especially among the youth, are also persistently high. The region's past growth was mainly driven by volatile sources such as commodity exports and remittance flows. The CCA countries are in need of a new economic model that can deliver sustainable, inclusive, more diversified, and less volatile growth. Bolder structural reforms, in several areas, are required to overcome the long-lasting impediments that are preventing the region from moving toward a new economic model and achieving its potential (see also IMF 2014b).

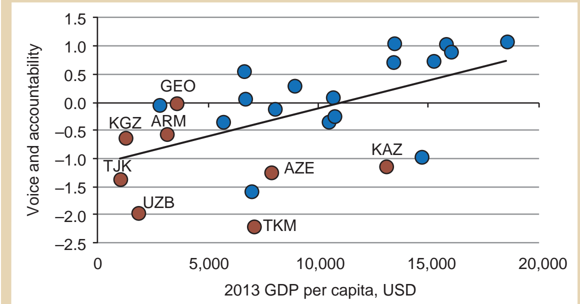
Higher, inclusive, and sustainable growth requires an increasing focus on productivity as a key driver (Annex I). During the past decade, economic growth in the CCA countries was driven by capital accumulation to a much larger extent than in other emerging markets that have comparable gaps in infrastructure (Annexes I–II). For productivity to make a larger contribution to growth, bold reforms are necessary to develop worker talent, competitiveness of the business environment (especially governance, regulatory quality, and the rule of law), and labor market efficiency (Figure 3.13 and Annex I). CCA countries also need to speed up structural reforms in areas such as governance, business climate, education, the financial sector, and informality, to create an environment conducive to private sector–led growth (Figure 3.14 and Annex I). Perceived corruption continues to be a main hurdle for business development; progress in eradicating corruption has been mixed (Figure 3.15).

Although economic growth in the region has been strong over the past decade, employment has not kept pace, suggesting an urgent need to improve frameworks for economic decision making and to increase focus on the inclusiveness of growth (Figure 3.16). Economic growth that is not inclusive, even if it is high, may fail to garner public support over the long term and thus may not be sustainable (Annex IV). Broader institutional reforms will not only promote inclusiveness, but will also help release constraints on the implementation of other structural reforms. Recent studies (Ben Naceur and Zhang forthcoming) show that measures such as increased trade and financial integration, and strengthening financial access (Annex III), deepening, and stability can reduce poverty and promote inclusive growth in the CCA.

Figure 3.13

CCA versus Emerging Markets: Voice and Accountability

(–2.5 to +2.5 score, higher is better)



Sources: IMF; and World Bank, World Governance Indicators.

Creating a diverse and dynamic non-oil tradable sector is another priority for the region. Recent studies (Cherif and Hasanov 2014) show that further export diversification will require better infrastructure and legal frameworks, technological upgrades, and measures to address market imperfections (Figure 3.17). Countries can start by promoting linkages and diversification in the industries where they enjoy a comparative advantage.

Balanced regional and multilateral trade integration initiatives can also help diversify economies and improve medium-term growth prospects. Recent efforts in these areas are welcome, including the accession of Kazakhstan to the World Trade

Figure 3.14

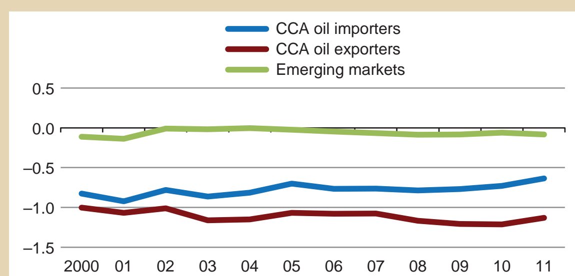
Sustainable Growth Requires Bold Structural Reforms[1]

Sources: Labor: World Economic Forum (WEF); Corruption: PRS; Infrastructure: WEF; Trade: WEF; Education: WEF; Legal: WEF and World Bank Doing Business; Finance: WEF and World Bank Doing Business; Bureaucracy: PRS; Regulations: World Bank Worldwide Governance Indicators.
[1]Data unavailable for Tajikistan, Turkmenistan, and Uzbekistan.

Figure 3.15

Control of Corruption[1]

(Score; higher is less corruption)

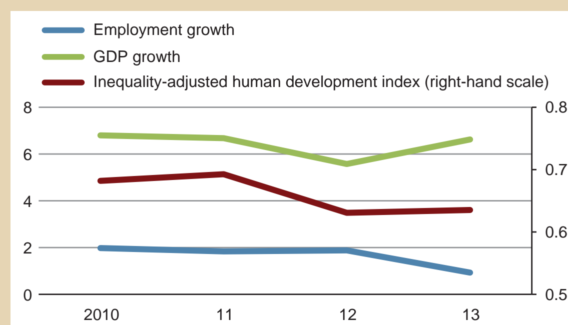


Source: World Bank, World Governance Indicators.
[1]Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

Figure 3.16

CCA: Growth, Inequality, and Employment

(Year-over-year percent change, unless noted)

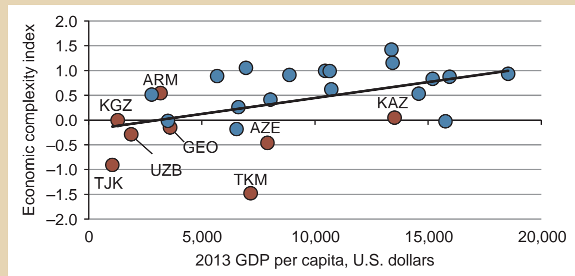


Sources: National authorities; United Nations Human Development Index; and IMF staff estimates.

Figure 3.17

CCA versus Emerging Markets: Economic Complexity[1]

(–3 to +3 scoring scale; higher is better)



Source: Economic Complexity Index, http://atlas.media.mit.edu/ranking/country.

[1]Measures productive knowledge and economic sophistication, based on trade statistics.

Organization, expected by year-end, and Georgia's harmonization with the European Union with the signing of the recent Deep and Comprehensive Free Trade Agreement. Progress on the Eurasian Economic Union (EEU) also offers prospects for enhanced trade and financial flows, with Armenia and the Kyrgyz Republic expected to join Belarus, Kazakhstan, and Russia in the future. Although the EEU will provide member countries with access to large regional markets and, potentially, additional project financing from Russia, important challenges exist, including higher common tariffs in the EEU than exist now in Armenia and the Kyrgyz Republic. Negotiations will be required to avoid conflict with Armenia's World Trade Organization obligations, and, in the case of the Kyrgyz Republic, to slow tariff increases. The impact on medium-term growth will depend on the trade creation and diversion that would result from a high common external tariff, as well as on how the EEU rules and regulations on the mobility of goods, capital, and labor will be implemented (Annex V).

CCA: Selected Economic Indicators

	Average 2000–10	2011	2012	2013	Projections 2014	2015
Real GDP Growth	**9.1**	**6.7**	**5.6**	**6.6**	**5.5**	**5.6**
(Annual change; percent)						
Armenia	8.2	4.7	7.1	3.5	3.2	3.5
Azerbaijan	13.9	0.1	2.2	5.8	4.5	4.3
Georgia	5.9	7.2	6.2	3.2	5.0	5.0
Kazakhstan	8.5	7.5	5.0	6.0	4.6	4.7
Kyrgyz Republic	4.2	6.0	–0.9	10.5	4.1	4.9
Tajikistan	8.0	7.4	7.5	7.4	6.0	6.0
Turkmenistan	13.8	14.7	11.1	10.2	10.1	11.5
Uzbekistan	6.7	8.3	8.2	8.0	7.0	6.5
Consumer Price Inflation	**9.8**	**9.0**	**5.3**	**6.0**	**6.4**	**6.4**
(Year average; percent)						
Armenia	3.9	7.7	2.5	5.8	1.8	3.8
Azerbaijan	7.1	7.9	1.0	2.4	2.8	3.0
Georgia	6.4	8.5	–0.9	–0.5	4.6	4.9
Kazakhstan	9.0	8.3	5.1	5.8	6.9	6.1
Kyrgyz Republic	8.6	16.6	2.8	6.6	8.0	8.9
Tajikistan	15.5	12.4	5.8	5.0	6.6	8.3
Turkmenistan	7.4	5.3	5.3	6.8	5.0	5.5
Uzbekistan	15.5	12.8	12.1	11.2	10.0	11.2
General Government Overall Fiscal Balance	**2.2**	**6.7**	**4.7**	**2.8**	**1.6**	**1.0**
(Percent of GDP)						
Armenia[1]	–3.5	–2.9	–1.6	–1.7	–1.7	–2.0
Azerbaijan[1]	4.2	13.6	4.9	0.8	0.3	–1.7
Georgia	–3.1	–3.6	–3.0	–2.6	–3.7	–3.0
Kazakhstan	2.5	5.9	4.5	5.0	3.7	3.1
Kyrgyz Republic	–4.1	–4.6	–5.3	–4.0	–4.4	–3.2
Tajikistan	–3.2	–2.1	0.6	–0.8	–0.6	–1.3
Turkmenistan[2]	3.1	3.6	6.4	1.3	0.0	0.6
Uzbekistan	2.3	8.8	8.5	2.9	0.6	0.5
Current Account Balance	**0.8**	**7.3**	**3.2**	**1.9**	**1.6**	**0.7**
(Percent of GDP)						
Armenia	–9.3	–11.1	–11.1	–8.0	–7.7	–7.3
Azerbaijan	5.3	26.5	21.8	17.0	14.6	10.4
Georgia	–11.5	–12.8	–11.7	–5.9	–8.4	–7.9
Kazakhstan	–1.5	5.4	0.5	–0.1	0.3	–0.7
Kyrgyz Republic	–3.1	–9.6	–15.9	–14.8	–14.2	–14.8
Tajikistan	–3.8	–4.8	–1.5	–1.4	–4.7	–3.6
Turkmenistan	4.3	2.0	0.0	–2.9	–1.9	–0.3
Uzbekistan	5.1	5.8	1.2	0.1	0.1	0.5

Sources: National authorities; and IMF staff estimates and projections.
[1]Central government.
[2]State government.