

KEY POLITICAL RISKS FACING CENTRAL ASIA IN 2023

Regional political outlook on Central Asia for 2023

February 2023

EXECUTIVE SUMMARY

2022 brought many systemic challenges to the countries of Central Asia. Massive unrest and cross-border conflicts, disruption of external trade channels and a general destabilization of the geopolitical climate all reflect considerable risks to the investment climate.

For Kazakhstan, the region's largest economy, 2023 will be marked by the likely completion of a power transfer from former President Nursultan Nazarbayev to incumbent head of state Kassym-Jomart Tokayev. Following snap presidential elections and a series of constitutional changes, both of which were aimed at eliminating the power of Nazarbayev-linked ruling elites, the power transfer will culminate in snap parliamentary elections in March. The government is also expected to undergo a major restructuring, aimed at constructing a new economic model.

Neighbouring Uzbekistan is entering a period of profound political and administrative reform. At the same time, sweeping economic reforms initiated by President Shavkat Mirziyoyev may be slowed by the chaos in the state administration, caused by the recent reorganization of the executive branch. In addition, the ruling elite is also planning a constitutional referendum to ensure that Mirziyoyev retains power, possibly until 2036, reducing the predictability of regulatory policies.

For international businesses, Kyrgyzstan remains a rather unstable territory, both in terms of various conflicts between pressure groups provoking popular uprisings, as well as due to border disputes with Tajikistan. The legislative environment is constantly being amended in an attempt to adjust to the changing international circumstances. Another concern is the country's underdeveloped basic infrastructure, accompanied by energy problems.

Tajikistan's socio-economic situation has not changed significantly since 2021, not even against the backdrop of Russia's war against Ukraine and its impact for the region. At the same time, the overall region, in light of Russia's high influence, as well as the overlapping interests of China and the West, has a high level of dependence on these global centres of power. Accordingly, Central Asian countries, especially Kazakhstan and Uzbekistan, will continue to maintain a multi-vector approach to foreign policy and international relations.

Below, Aretera provides its outlook on Central Asia for 2023, with key implications for investors.

KAZAKHSTAN'S POLITICAL RESTRUCTURING

For Kazakhstan, last year brought huge tension to the political system established under former President Nursultan Nazarbayev. Central Asia's largest economy has seen a large-scale reconfiguration of its political and business elites following the mass riots of January 2022, which culminated in armed civil clashes. During and after the crisis, the incumbent President of Kazakhstan, Kassym-Jomart Tokayev, began to dismantle the model of power built by Nazarbayev. Many representatives of Nazarbayev's entourage, including the business elite and various governmental structures, have been investigated and the members of Nazarbayev's clan, which were extremely influential in the past, are now being prosecuted and pushed out of power.

Tokayev's actions had one goal: to concentrate power in his own hands and finally deprive Nazarbayev of any influence on state politics. The former President was ousted as chairman for life of the Security Council and stripped of virtually all his privileges. Subsequently, Tokayev [initiated](#) constitutional reform, including a referendum last June aimed at creating the legal basis for removing Nazarbayev and his entourage from power. Last November, early presidential elections were also held, resulting in a landslide win for Tokayev and the popular approval of his constitutional reforms, which limit the president's powers to a single term of seven years.

2023 started with the country's parliament repealing a law on the powers of the "First President" (a title previously held by Nazarbayev), minimizing his actual powers and revoking the immunity of his family members. On 14 January, partial elections were held to the upper house of the Kazakhstani parliament (Senate), resulting in the upper chamber being composed of people loyal to Tokayev only. Accordingly, Tokayev has managed to almost completely remove his predecessor and his inner circle from power, while those elites which adopted a 'wait-and-see' attitude now side with the President. For a final consolidation of power, Tokayev needs to ensure the loyalty of the lower chamber of parliament (Majilis), which he plans to secure via snap elections scheduled for March.

KEY EXPECTATIONS FOR KAZAKHSTAN IN 2023

The extraordinary elections to be held on 19 March will be fully controlled by the authorities. With the formation of the new parliament, the process of restructuring of the elites of Kazakhstan will be completed. All power will be concentrated in the hands of Tokayev, since de facto representative political institutions in Kazakhstan (parliament, local legislative bodies) have no real powers and are subordinate to the centre. Following the snap elections, the country's government will resign, which may lead to personnel changes in the structure of the Cabinet of Ministers during the formation of its new composition. However, familiar faces in the higher echelons of power will remain, as Tokayev is experiencing an acute shortage of personnel both at the central governmental level and in the country's regions.

President Tokayev is also pushing for a restructuring of the country's current economic model. The main idea of this process is to divide responsibilities between the state and business by strengthening the sectoral regulatory powers of various non-governmental structures, including sectoral associations, as well as the influential National Chamber of Entrepreneurs (Atameken). As a consequence, a revision of regulatory approaches and practices at all levels will intensify, focusing on reforms in trade (ensuring traceability of goods), taxation (new Tax Code and implementation of platform employment), the information and communication sector: adoption of the Digital Code and implementation of online platform regulation, as well as tightening regulation of personal data circulation and ensuring data commercialization and beyond.

For international businesses, the main risks include a public administration reform that may lead to a change of key operational-level stakeholders in the executive branch and disruptions in the regulatory process and in communication with businesses. This could mean reduced opportunities to influence regulatory policy due to change of some key stakeholders in the central government.

An additional concern is the complication and tightening of sectoral regulations as a result of economic restructuring. Sharp conjunctural changes in foreign and domestic policy amid the unstable geopolitical situation over Russia's war against Ukraine and Kazakhstan's strong but strained ties to Russia mean an additional risk going forward.

REFORM OF THE PUBLIC ADMINISTRATION SYSTEM IN UZBEKISTAN

On 24 December 2022, Uzbekistani President Shavkat Mirziyoyev launched an administrative [reform](#), which involved a major change of regulators for key sectors of the economy. A number of national-level ministries and agencies were abolished, civil servants were reduced by a quarter, and super-ministries were created as key economic regulators (Ministry of Economy and Finance and Ministry of Investment, Industry and Trade).

The first major piece of reform was the formation of a new government on 30 December 2022. A [reorganization](#) of Uzbekistan's public administration system, aimed at optimizing the work of the state apparatus, is currently underway. Critics, however, argue that the result has been managerial chaos. The redistribution of functions between regulators, which also includes the transfer of various institutions (committees, departments, whole sector units), has disturbed operational teams, bringing a breakdown in communications and lack of clarity in areas of responsibility. The regulatory crisis has also slowed down economic reforms, including tax, investment and trade reforms, as well as privatization processes, a priority of government policy.

In Uzbekistan, the state is the main actor in the economy, which hinders its progressive development. President Mirziyoyev has been trying to solve this problem since 2019 by launching a large-scale campaign to privatize state assets (banks, energy, industry). However, so far only one state-owned company – the largest carmaker in Central Asia, UzAuto Motors – has launched a partial IPO on the domestic market. IPOs of several industrial companies in the mining and energy sectors have been planned for this year, but administrative reforms are slowing down these processes.

Against this background, a large-scale political reform is also underway, which aims to keep Mirziyoyev in power. He has been in power since 2016, following the death of former permanent leader Islam Karimov. His second and last presidential term under the current constitution expires in 2026. A referendum to amend the country's constitution was to be held in 2022, the main purpose of which was to "zero out" the presidential term of the incumbent head of state. However, following the publication of the draft amendments in the country's autonomous Republic of Karakalpakstan, the largest region in Uzbekistan, mass unrest erupted in July 2022 over the planned change in the status of the region.

As a result of the state of [emergency](#) and the ensuing armed clashes, the referendum was postponed until 2023 and some articles of the planned reform were revised. Nevertheless, the main objective of the referendum – annulling presidential terms – remains unchanged.

KEY EXPECTATIONS FOR UZBEKISTAN IN 2023

A referendum on constitutional amendments will take place in spring 2023. Despite the crisis of the state administration system, President Mirziyoyev will retain power and continue the course of economic reforms aimed at expanding the country's trade and economic relations on the external circuit. Operational problems in the state apparatus will persist throughout the year. The authorities will continue with sectoral regulatory changes aimed at de-nationalizing the economy and stimulating business activity. However, at the departmental level, regulatory practices will be unclear and chaotic. Constitutional reform will be the legal basis for significant political processes. Among other initiatives, preparatory processes for early presidential and parliamentary elections in 2024 are likely to be launched.

Regarding risks facing international companies, administrative reform will likely result in a change of key operational level stakeholders within the regulators (deputy ministers, heads of committees and agencies, sectoral structural units). This will not only complicate communications with the regulators, but also reduce the possibilities to influence the regulatory policy and jeopardize the work under the current arrangements. Due to the unclear functioning model of the state apparatus, the short- and medium-term planning of business development strategies will likely get more complicated.

In addition, given the likely early launch of electoral cycles, the authorities may shift to populist reforms, the impact of which on business operations will be difficult to predict. An additional concern is the disruption of key sectoral reforms and significant general economic transformations due to the restructuring of the public administration system, as well as the disruption or postponement of existing agreements, including investment contracts, due to changes in stakeholders and reallocation of responsibilities of public contractors.

KYRGYZSTAN'S INTERNAL POLITICAL INSTABILITY

Kyrgyzstan continues to experience political and economic instability. President Sadyr Japarov, who came to power after political turmoil in October 2020, was elected president in January 2021 with the support of 80% of voters. Immediately after his election, he initiated constitutional reform, confirmed in a popular referendum in January 2021. Under this reform, Kyrgyzstan changed its form of governance from a semi-presidential republic to a presidential system. The head of state is in charge of the executive branch and has the right to propose legislation. Among other changes, a new institution, the Kurultai – a deliberative and supervisory public-representative assembly that makes recommendations on the direction of social development – is being introduced.

The Kurultai, which is an additional institution for the president to influence public opinion, is tasked with dialogue between the country's various communities, achieving national consensus on the development of regions, and forming recommendations to the government on key decisions. Simultaneously, the number of MPs in the country's parliament was reduced from 120 to 90, while the proposed measures also include norms that provide state guarantees to investors and articles that regulate interaction between the state and the private sector.

Kyrgyzstan's economy is highly exposed to external shocks due to its small size, high dependence on remittances from labour migrants, foreign loans and gold mining. Government and presidential policies are focused on developing the private sector and stimulating international trade. Accordingly, Kyrgyzstan remains a rather unstable territory for businesses, both in terms of various conflicts between pressure groups provoking popular uprisings. Legislation is constantly being edited and amended in an attempt to adjust to changing circumstances in the world, while another

inconvenience in doing business is the underdeveloped infrastructure (energy problems, lack of roads, weak internet, etc.).

KEY EXPECTATIONS FOR KYRGYZSTAN IN 2023

The main 2022 regulatory trends that will continue to influence business processes in 2023 are likely to include tax reform, which started in 2022 and aims to improve tax administration and its digitalization. So far, the focus of the tax reform is on SMEs: due to the massive dissatisfaction of entrepreneurs with the adopted changes, the government will reduce taxes on small businesses. No significant changes are expected for large businesses and foreign investors. Legislatively, relations with investors are regulated by separate rules and run separately from other entrepreneurs.

Changes in relation to the Kyrgyzstan and the Russian-led Eurasian Economic Union (EAEU) are also expected. Kyrgyzstan is actively participating in the EAEU integration process within the Eurasian Union, strengthening its relationship with Russia. Regulation will continue to be brought in line with the norms of the EAEU, while it will, in some places, copy Russian legislation. In 2023, the focus will be on technical regulation processes, digitalization and harmonization with EAEU norms.

In 2023, the country's budget will remain in deficit. Inflation in Kyrgyzstan was 14.7% at the end of 2022. The country's central bank expects inflation pressure to continue, fuelled by external factors and high international economic uncertainty. While the government does not appear to be planning measures to control inflation, a separate problem will be the situation on the foreign exchange markets, which experienced a significant shock last year. This included a shortage of cash dollars, which were in demand from Russians who started to change their savings. The authorities introduced currency exchange restrictions and cash-out fees, leading to the creation of a shadow currency market. Businesses in turn introduced exchange rate differences on the cost of goods and services, which negatively affects the overall economic situation.

Long-running border disputes with neighbouring Tajikistan are also likely to continue. Both countries rely on mediation, including military assistance, from Russia to resolve the conflict, with the decades-long border disputes inflicting serious economic damage on both countries. The disputed areas account for some 30% of the length of the border line, while the clashes in 2022 can be described as the bloodiest in the history of Kyrgyz-Tajik border conflicts. At the same time, talks about border demarcation and delimitation are ongoing.

The country is also expected to strengthen its ties with Russia, its strategic partner. Russian state companies plan to build a small capacity nuclear power plant and reconstruct a major railway line in the country, while other agreements have been reached on various infrastructure projects. Bilateral projects in culture and education have also been stepped up, which also serve as tool for Russian soft power.

EXPECTED POWER TRANSFER IN TAJIKISTAN

Tajikistan's socio-economic situation has not changed significantly in the past two years, not even against the backdrop of Russia's war against Ukraine. The country's leadership continues to pursue an isolated authoritarian policy with increased state regulation of the economy. The political situation in the country is relatively stable. Power is concentrated in the hands of the incumbent president, Emomali Rahmon.

Similar to the scenario in neighbouring Turkmenistan, it is expected that the successor to the incumbent President will be his eldest son, Rustam Emomali, who has been the chairman of the National Council (Majlisi Milli - the upper house of the Supreme Assembly) since 2020.

According to the Constitution, the post of chairman of the National Council is second in the country's government hierarchy. In the event of the early resignation of the President, his duties are transferred to the chairman of the National Council until a new president is elected. The Tajik authorities maintain a neutral stance in the current geopolitical situation with a demonstration of multi-vector government policies. However, Tajikistan still maintains close ties with the Russian authorities.

So far, Tajikistan has not made any official statements on the adoption of anti-crisis measures, despite the fact that Russian sanctions pressure is having a negative impact on the country's economy, most particularly on its national currency. The country's economic dependence on Russia is primarily due to a significant share of its foreign trade turnover, active labour migration of its citizens to Russia and military cooperation. Remittances from Tajik migrants from Russia to Tajikistan (as well as to Kyrgyzstan and Uzbekistan) reached record levels in 2022, despite negative forecasts following the start of the war in Ukraine, largely due to the relative stability of the Russian ruble.

China also exerts considerable economic and political influence in the region, in particular following the US withdrawal from neighbouring Afghanistan. Despite China's position on the situation in Afghanistan, Chinese-Tajik relations are characterized as stable. Tajikistan's position on Afghanistan is tough relative to neighbouring countries in the region: the president still [insists](#) on the need to establish an inclusive government and to take into account the interests of national minorities, which include those represented by Tajiks.

Given the current situation and stability in Tajikistan's political power, no significant shifts in the country's economy are expected in 2023. Relevant issues for this year include a hoped-for resolution to the border dispute with Kyrgyzstan. Maintaining a stable economic situation, as well as ensuring uninterrupted trade and monetary transactions, are also among the main challenges, in addition to ensuring electricity in light of major and intermittent blackouts last year.

TURKMENISTAN'S NOMINAL POWER TRANSFER

Turkmenistan maintains one of the most authoritarian regimes in the region. Incumbent President Serdar Berdimukhamedov was elected in March 2022 in an early presidential election. This election was essentially a formal transfer of power from the previous president, Gurbanguly Berdimukhamedov, to his son. The formality of the transfer of power was evidenced by the constitutional reform that took place earlier this year: on 21 January, President Serdar Berdimukhamedov [signed](#) a constitutional law on the Khalk Maslakhaty (People's Assembly), removing the body from parliament and making the People's Assembly the country's highest representative body. Its main functions include considering and approving constitutional proposals, as well as strategic domestic, foreign and security policies.

Berdimukhamedov Sr. [was appointed](#) Chairman of the Khalk Maslakhaty, whose decisions in this position are binding on the President and the Government of the country. In addition, the Constitutional [Law](#) on the National Leader was also signed on 21 January, granting Gurbanguly Berdimukhamedov and members of his family almost absolute immunity. At the same time, it grants Berdimukhamedov extensive powers, including the right to address the people of the country and take initiatives that are effectively binding on state authorities.

Thus, the supreme power in Turkmenistan is de facto officially reserved for Gurbanguly Berdymukhamedov, while the incumbent president has a more of a representative function.

Turkmenistan's economy is subject to strict administrative control and the dominance of the public sector. Assessing the real state of Turkmenistan's economy is difficult due to the closed nature of the country and the unreliability of the information provided by its government. However, the export of natural resources (hydrocarbons) dominates the country's income structure, while Russia and China are the biggest buyers of Turkmen gas.

Turkmenistan maintains its status of permanent neutrality in international relations and will remain one of the least integrated countries in the world economy. However, in 2021, Turkmenistan officially applied for membership of the WTO, where it has been an observer since 2020. In this regard, Turkmen authorities may attempt to liberalize the current foreign trade, customs and tax policies. However, significant reforms should not be expected. In view of a strengthening authoritarian regime and a lack of transparency in state regulation, Turkmenistan's remains a difficult climate for doing business and foreign investment. Decisions to allow a company to enter the country's domestic market are politically motivated and doing business is also complicated by the low level of development of the necessary infrastructure, as well as by the authorities' total control over the internet, to the point of shutting it down on a periodic basis.

IMPLICATIONS FOR INVESTORS

2022 revealed many systemic internal and external challenges in the countries of Central Asia. Massive unrest and cross-border conflicts, complemented by disruption of external trade channels and a general destabilization of the geopolitical climate, all reflect the need for systemic change in the countries of the region. At the moment, however, most Central Asian states lack the necessary political will for profound reforms, due to both authoritarian regimes in almost all countries and structural economic problems.

Nevertheless, the authorities in most of the countries, above all Kazakhstan and Uzbekistan, in their desire to diversify and improve the sustainability and productivity of their economies, have been actively building ties with foreign investors, working to improve the investment climate, relocate large businesses that left Russia, form new supply chains, and generally increase the security of foreign investments. At the same time, Central Asia, in light of Russia's high influence on the region, as well as the overlapping interests of China and the West, has a high level of dependence on these global centres of power. The region, and especially Kazakhstan and Uzbekistan, is forced to balance these interests, adhering to a policy of metered multi-vector cooperation.

As a consequence, any dramatic reorientation of the region's major economies on a geopolitical level remains unlikely in 2023. However, it is clear that countries will compete for investors on the global corporate market and strive to create the most favourable business environment for them. The specifics of the region mean that the economies are directly dependent on politics and the regulatory environment can change extremely quickly.

For Kazakhstan, the region's largest economy, 2023 will be a transitional period in building a new model of interaction between the state and business. President Tokayev's attempt to consolidate power creates risks of the redistribution of financial and industrial assets in favour of his entourage. New figures in power in the future may start revising existing contracts with large foreign investors, which were concluded in Nazarbayev's era, to demand dividends for themselves.

Although the Kazakh authorities claim to be committed to all external commitments, such risks should be taken into account when shaping a business strategy in Kazakhstan.

Overall, neighbouring Uzbekistan will also face significant political and administrative changes this year, with a potential to significantly impact the country's economy. Given the impact of external factors, including the geopolitical uncertainty, Uzbekistan is entering a period when it remains difficult to predict functional, communication and operational disruptions that will put pressure on business activity in the country.

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