

Investing in multisectoral projects in Central Asia: challenges and opportunities

In February 2023, the 7th EU-Central Asia High-Level Conference on Environment and Water Cooperation was held in Rome, Italy. Delegates from the countries of the European Union, Central Asia and representatives of international organizations discussed the achievements and necessary steps for cooperation, expansion of political dialogue and capacity building in the field of environmental protection, climate change and water resources.



In the lead-up to the High-level conference the special event to promote green investments based on the WEF Nexus approach took place under EU funded project “Nexus Dialogue in Central Asia”¹. During the special event the important and sensitive issue of attracting private sector investment in water, energy and agriculture projects was raised, what is hindering, what needs to be changed and what support development partners can provide to this process. The developers of investment projects spoke about the difficulties they face when looking for investments, representatives of international financial institutions (IFIs) and donors spoke about the conditions necessary to attract private capital and gave recommendations on attracting the interest of local and foreign private businesses.

As a result of the discussions, the speakers and participants came to the conclusion that this is a complex classical problem and there is no easy solution to it. The introduction of any new technologies, and especially "green" technologies, is a costly and long-term process that requires a systematic approach. As Dr. Jörgen Keinhorst (Federal Ministry for the Environment, Nature Conservation and Nuclear Safety of Germany) put it: “... grants are becoming scarce and countries must rely more and more on generating and using their internal potential and in this perspective the private sector must be prioritized...”

"Circle of Sansara" around water management, energy and agricultural facilities

It is clear that any investor is looking for political stability, economic and financial openness to private capital. The ultimate goal of a private investor is the payback of the project and making a profit. While water-energy and agricultural (WEP) projects do not bring quick and desirable payback to the private sector. Regulated tariffs for water and electricity limit the profitability of a project, while degraded infrastructure requires massive capital investment. Large investors continue to invest in projects related to oil production and refining (for example, case of Kazakhstan shows that the Netherlands, Germany and France remain large investors in these sectors for decades²).

While WEP projects are vital for meeting the needs of the population, supporting the country's economy itself, as well as ensuring security, they do not receive due interest from investors due to their low marginality and the lack of a motivating legal and regulatory framework.

The second most important factor for the investor is the “ownership of the project”. Taking into account that WEP objects are socially significant objects in state ownership, most of the CA countries do not transfer such objects to private ownership and do not finance through PPP schemes. The costs of construction and modernization of such WEP facilities (for example, reservoirs, pumping stations, water canals, etc.) are paid from the state budget or by attracting low-cost and long-term loans from international financial institutions (about 1%). At the same time, the state regulates tariffs, and, given the low solvency of the population, provides subsidies or writes off accumulated debt in sectors. For example, during the implementation of the Nexus demo project in Tajikistan, it was revealed that in

¹ Minutes of the thematic meeting are available at [link](#)

²Source: Ministry of Finance of the Republic of Kazakhstan

2014 and 2018 the Government canceled the debts of the Agency for Melioration and Irrigation under the Government of the Republic of Tajikistan in front of the Barki Tojik (national electricity operator) in the total amount of 314.8 million somoni (about 29.5 million euros)³.

In this scenario, there are not enough resources to increase capacity and improve its quality, and over time, the government/municipalities have to impose restrictions on the quantity or quality of services provided. As such, in the spring of 2023 in Astana, Kazakhstan, the municipality had to introduce restrictions on water pressure according to the schedule at various hours of the day due to a lack of capacity for the production of drinking water⁴. In Tajikistan, due to weakened aggregates large pumping stations are not able to pump the required volume of water. As a result, water no longer reaches the end sections of the water canals TM-1 and TM-2 (Fig 2.), endangering agribusiness and their ultimate solvency (not to mention the creation of “unfair distribution” conditions by putting agribusiness up the channel in a better position initially). Another example is the city of Ridder, Kazakhstan, where at the end of 2022 an emergency shutdown of two boilers at the Ridder CHPP occurred due to their deterioration. As a result, more than 20 thousand families and SMEs were left without heat in severe frosts⁵. There are more such examples with increasing depreciation of capacities.



The economy will not grow and strengthen, business will not invest and expand until (everything) is at market prices.

Yes, the income of the population, along with the normalization of company revenues, should also grow. Distortions will disappear. Unreasonable subsidies will be canceled. Wrong regulation (in the form of bans on exports or imports) will go into oblivion.

I changed my mind; shock therapy is shock. So, it is not necessary. The population should not be stressed. But with proper communication, a gradual leveling of prices over 5 years is a very real scenario for the transition to a real market economy.

Source: Yerlan Ospanov, General Director, Managing Partner, Vernuy Capital

Such a “Circle of Samsara” is a classic phenomenon and its transformation into the use of internal resources requires political will, resources, and later discipline / systems and work with the population to reflect the first stream of its primary consequences, which may not be immediately positive.

The European Union and the World Bank play a key role in advancing reforms at the state level and providing support for reforms, adaptation of new approaches and financing of projects of social importance that are not attractive to the private sector. In the next few years, the EU plans to allocate about 200 million EURO to address environmental issues in Central Asia and facilitate the transition to a green economy. However, the efforts and support of only state bodies and the donor community will not be enough for a full-scale transition to a green economy, and the participation of the private sector is mandatory. However, the private sector receives loans on commercial terms, which brings us back to the "Circle of Samsara" about the non-repayment of WEP projects and the low solvency of the population.

Donor Community Recommendations

International and European banks consider not only the regulatory and regulatory framework of the country, but also pay attention to the presence of international, and, in particular, European standards that countries are implementing in their technological processes. European investors have their own "green" requirements, which they will take into account when deciding whether to finance an investment project. For example, the European Bank for Reconstruction and Development does not consider investing in coal plants or industrial enterprises that will use coal without the introduction of green technologies.

³1 euro = 10.7 somoni as of July 6, 2022, data from the National Bank of the Republic of Tajikistan (<https://nbt.tj/ru/>)

⁴Source: <https://bizmedia.kz/2023/03/28/v-astane-normiruyut-davlenie-pitevoj-vody-po-grafiku-iz-za-deficizita/>

⁵<https://rus.azattyq.org/a/kazakhstan-ridder-accident-at-a-thermal-power-plant/32125234.html>

The economies of the Central Asian countries have weathered the COVID-19 pandemic relatively well and reforms are ongoing. For example, Kazakhstan at the beginning of 2023 adopted the “Law on Agglomerations”, which opens external financing for the municipality of Almaty city in the form of loans or the issuance of green bonds on the platform of the Astana International Financial Center in national currency to finance “green” projects⁶. However, creating a more favorable environment for the development of the private sector and the decarbonization of the economy will require significant reforms. At the moment, the Central Asian countries do not occupy high positions in the World Bank's report "Doing Business - 2022"⁷ and there are still many issues that countries need to improve, in particular the development of a regulatory framework, implementation of tax reforms, labor market regulation, contract enforcement, simplification of the coordination and approval of design estimates in the construction industry and export-import trade, development of environmental standards environment and how the country is ready to invest in green projects.



The donor community, including the European Union, the World Bank, the Swiss Development Agency, the German Society for International Cooperation (GIZ) and other donors, confirmed their readiness to continue supporting the CA countries in carrying out the necessary reforms. In addition, the European Investment Bank is starting to open branches in the Central Asian countries to improve local operations and, subsequently, to increase the flow of foreign private capital.

Given that green infrastructure projects carry risks for the private sector, it is necessary to use risk mitigation tools for the private sector. The donor community can help countries be more creative on this issue.

Difficulty in implementing multisectoral projects

Multisectoral as well as regional investment projects are absolutely necessary (especially in the face of growing scarcity of natural resources), but are very complex, requiring a lot of time and resources to agree on the concept, develop project design, coordinate line ministries and implement. At the same time, each stage has its own risks. Based on the practical experience of the World Bank, success in the implementation of complex projects requires the presence of a strong regional organization. In turn, the development of institutionally and professionally strong regional organizations requires the support of the donor community.

At the national level, line ministries and departments work within their mandates. There is competition for natural resources to meet the needs of their sectors and beneficiaries. Permanent multisectoral platforms for the development and approval of investment projects have not been identified. Due to limited resources and sectorally regulated tasks, it is not necessary to count on the “voluntary” introduction of an intersectoral approach by one of the sectoral departments for joint planning and design of investment projects for a more rational use of natural resources.

Supporting the promotion of the intersectoral approach Water-Energy-Food (Nexus) in Central Asia and its institutionalization, the following observations were made: at present, there is an active participation of representatives of the water sector and, more recently, energy, however, there is still no participation of the ministries of national economy, finance and investments to strengthen the multisectoral approach in public policy in the strategic planning of sectors and investments.

⁶<https://www.zakon.kz/6380513-tokaev-podpisal-zakon-o-razvitii-aglomeratsiy.html>

⁷Kazakhstan - 25th place; Kyrgyz Republic 80s; Tajikistan - 106th; and Uzbekistan - 69th.

Despite the difficulties in implementing multisectoral projects and, in general, the absence of a definition that there are multisectoral projects in the legal field, there is a complete understanding that such projects are needed especially in the context of climate change and the growing gap between demand and supply for natural resources. This understanding is also present at the regional level. Thus, in the Aral Sea Basin Program-4, developed by the International Fund for Aral saving (IFAS) and adopted at the level of the heads of the Central Asian countries, 9 out of 34 investment projects are multisectoral; some projects have been already launched with the participation of donors.

The Nexus approach is a necessary tool for optimizing the use of natural and financial resources. International development partners provide technical support to promote the Nexus approach in the region. For example, today, the portfolio of investment projects of the World Bank in Central Asia is about \$USD12 billion out of which 10% falls on multisectoral projects. Currently, additional \$USD 300 million is being mobilized for multisectoral projects. The fourth phase of the CAWEP Trust Fund, administered by the World Bank, will focus on the development of multisectoral projects over the next 5-6 years. The European Union has been supporting the Global Program Nexus Dialogues in all regions of the world over the past years, including in Central Asia. In the past three years alone, three major grant projects have been launched in Central Asia promoting the Nexus approach.⁸

Barriers and challenges faced by developers of investment multisectoral projects

Over the last two years, representatives of sectoral ministries of Tajikistan, Turkmenistan and Uzbekistan have developed investment proposals taking into account the Nexus approach⁹ and submitted them to IFIs, development banks/funds and the private sector for review and funding. The developers admitted that the use of the Nexus approach when preparing an investment proposal improved the quality and depth of understanding of the problem of any level, the definition of technical solutions, the vision of partnership and possible financing mechanisms.

However, in the course of searching for and attracting investments, the developers encountered barriers and beliefs that did not allow them to fully disclose the scope of the proposed investment proposals, in particular:

- The private sector shows interest in investment proposals for demo projects. But (quite understandably) the private sector is interested, first of all, in the marginality of the investment project, which is difficult to ensure in the framework of the Nexus projects that cover strategic objects with regulated tariffs for such public goods as “water resources”, “electricity” and “food”. In addition, some investors require equity financing, which also involves the transfer of 40% or more of the assets of the object to the investor with the right to sell, which is difficult to imagine the transfer of ownership of strategic national or transboundary objects;
- The private sector is not interested in developing a feasibility study or pre-feasibility study without confirmed investor interest, as the document requires resources and quickly loses its relevance. In turn, interested investors require the submission of a feasibility study project for making a decision on financing. International financial institutions can finance the development of a feasibility study; for this, an external consultant is involved. Also, feasibility studies can be developed by executing agencies (this is evidenced by the demo project in Tajikistan) when a political decision is made on a loan for a particular project. However, private or external financing seems impossible to attract without a feasibility study and an investment of at least 50% of equity capital;
- IFIs and development banks have their own agenda and mechanism for working with countries that do not have financial instruments to work with Nexus projects;

⁸“USAID Regional Water and Environment Project in Central Asia”, IKI Project: “Nexus Approach to Combating Climate Change in the AFOLU Sector in Central Asia” and the EU “Hydro4U” Project

⁹Investment proposal: No. 1: Cleaning and processing of sediments from the Run-of-river reservoir at the Tuyamuyun hydroelectric complex; No. 2: Automation of power consumption monitoring at pumping stations in the Sughd region of Tajikistan; No. 3: Modernization of the Golonostep pumping station in the Sughd region of Tajikistan.

- Identifying investment project ideas within grant projects is an extremely useful exercise, but it does not allow sufficient development of an investment proposal, preparation of a feasibility study, market analysis, and cost-benefit calculations. A gap appears that hinders the adoption of an investment decision by both the national partner and the financial institution;

In addition, it was proposed to increase the private sector's understanding of the need to implement green projects using energy efficient equipment and to look for more innovative approaches to rational resource consumption than purely image reporting.

Search for mutual understanding between the state authorities and investors to eliminate the bias in investing in profitable oil projects and the optimal investment model for financing WEP projects will require time, resources and awareness of its consideration not only from an economic and financial point of view, but also take into account their enormous role in the life of the population and the national economy itself.

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