CAREC TRADE POLICY COORDINATING COMMITTEE

Outreach Seminars
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Presentation by
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CAREC TRADE POLICY COORDINATING COMMITTEE
PRESENTATION IN MEMBER COUNTRIES

I. INTRODUCTION

It is widely recognized that international trade generally fosters economic growth through improving allocation of resources, enhancing competition, and disciplining policy makers. In developing and transition countries, trade also contributes to economic growth by helping them attract foreign direct investment (FDI) and providing them access to modern technologies through imports and FDI inflows. Trade also increases the variety and improves the quality of goods available to consumers.

In this context, CAREC Trade Policy Coordinating Committee (TPCC) was formed to help CAREC member countries adopt more open trade regimes and coordinate their trade policies, so as to facilitate both intra- and inter-regional trade. It is the first CAREC committee established with focus exclusively on policies, not projects.

More specifically, it was agreed that the TPCC would assess current trade policies and trade policy initiatives in CAREC-member countries, address various trade agreements in the region, with a view to minimizing trade distorting effects; address trade liberalization in the context of the WTO and the desire of non-members to become members of WTO; and assist countries to accede to the WTO, including by providing them with information on the benefits of WTO membership. Since then several papers were prepared to facilitate discussions in the Committee (see attachment I).

During the Ministerial meeting in November 2005, it was agreed that there is a need to increase the awareness of the analytical work that has been done in and by the TPCC among key decision makers in all CAREC-member countries. Thus, the International Monetary Fund and Asian Development Bank were asked to arrange seminars in each CAREC-member country, designed to summarize the work done for the TPCC to date and the implications of this work for the various countries in CAREC.

The following sections provide a summary of the papers prepared for CAREC TPCC. They also include some recent information related to trade performance and policy of Central Asian Republics (CARs) from a draft report of the Asian Development Bank on Central Asia regional cooperation in trade policy, transport, and customs transit.

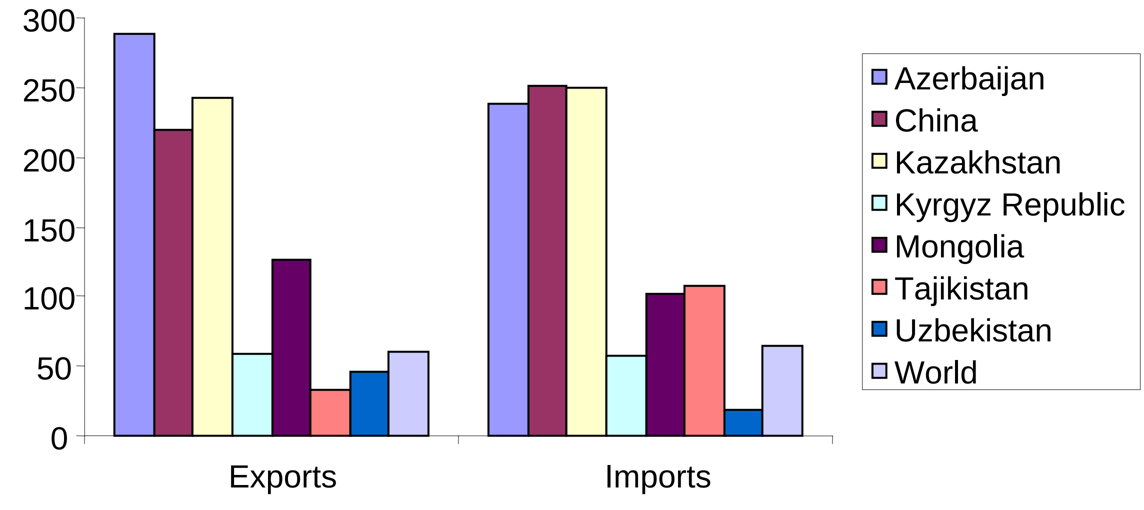
II. REGIONAL TRADE PERFORMANCE

Following the breakup of the former Soviet Union (FSU) in 1991, the trade levels of CARs (Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan) declined sharply in the early 1990s, reflecting the breakdown of trade links and payment mechanisms among the FSU countries and difficulties in engaging in trade with non-FSU countries. Since then, the

CARs have made considerable progress in expanding market-based trade with both FSU and non-FSU countries and integrating into the international trading system.

During 2000-2004, absolute levels of trade rose considerably in all CARs (Figure 1). In **Azerbaijan and Kazakhstan**, exports growth was boosted by an increase in the volume and prices of oil exports. Imports soared driven by an increase in imports of capital goods for oil sector development. In the **Kyrgyz Republic**, exports grew due largely to an increase in the volumes and prices of gold exports, and re-exports of kerosene for refueling of foreign military aircraft on the territory of the country. Imports growth was accounted by increases in imports of a wide range of products. In **Tajikistan**, exports grew mostly on account of an increase in the volumes of aluminum and cotton exports and a rise in world prices for these commodities. Imports grew driven by expansion of exports of capital goods. In **Uzbekistan**, exports continued to decline in 2000-2002, but rebounded in 2003 and 2004, supported by devaluation of the national currency, a rise in world commodity prices and expansion of exports of energy products and transportation equipment. Imports also increased substantially in 2003 and 2004, reflecting the introduction of current account convertibility in late 2003 and significant increases in imports of capital goods for state-supported investment projects.

Figure 1: Cumulative Growth of Merchandise Exports and Imports in CAREC Member Countries and World, 2000-2004
(In percent)

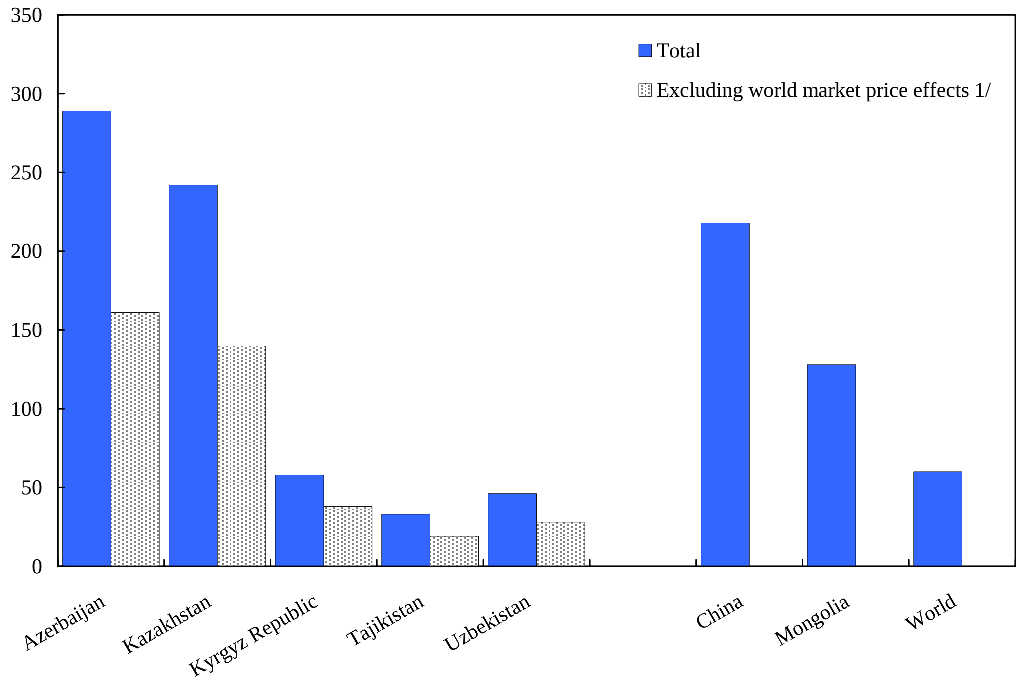


Sources: Governments of CARs, IMF's Direction of Trade Statistics and staff estimates.

Trade performance of CARs was not as impressive as it appears. Cumulative growth of exports in the Kyrgyz Republic, Tajikistan and Uzbekistan and cumulative growth of imports in the Kyrgyz Republic and Uzbekistan were lower than those in many other countries (including China and Mongolia—two other CAREC member countries) and the world as a whole. Excluding exports of crude oil and oil products and imports of capital goods for oil sector development, growth of exports and imports in Azerbaijan and Kazakhstan were also relatively modest.

The rise in world prices for primary commodities was a major factor contributing to the rapid growth of exports in the CARs in 2000-2004 (Figure 2). It is estimated that about half of the increase in exports in Azerbaijan and Kazakhstan was due to the rise in world prices for crude oil; one third of the increase in the Kyrgyz Republic's exports was due to the rise in world prices for gold; about half of the increase in Tajikistan's exports was due to the rise in world prices for aluminum and cotton fiber; and about two fifths of the increase in Uzbekistan's exports were due to the rise in world prices for gold and cotton fiber. On the import side, machinery and equipment made up a significant proportion of imports in all of the CARs. Imports of Azerbaijan and Kazakhstan were dominated by capital goods for oils sector development and mineral and chemical products remained major items in Kyrgyz Republic and Tajikistan.

Figure 2. Cumulative Growth of Merchandise Exports and World Market Price Effects, 2000−04 (in percent)

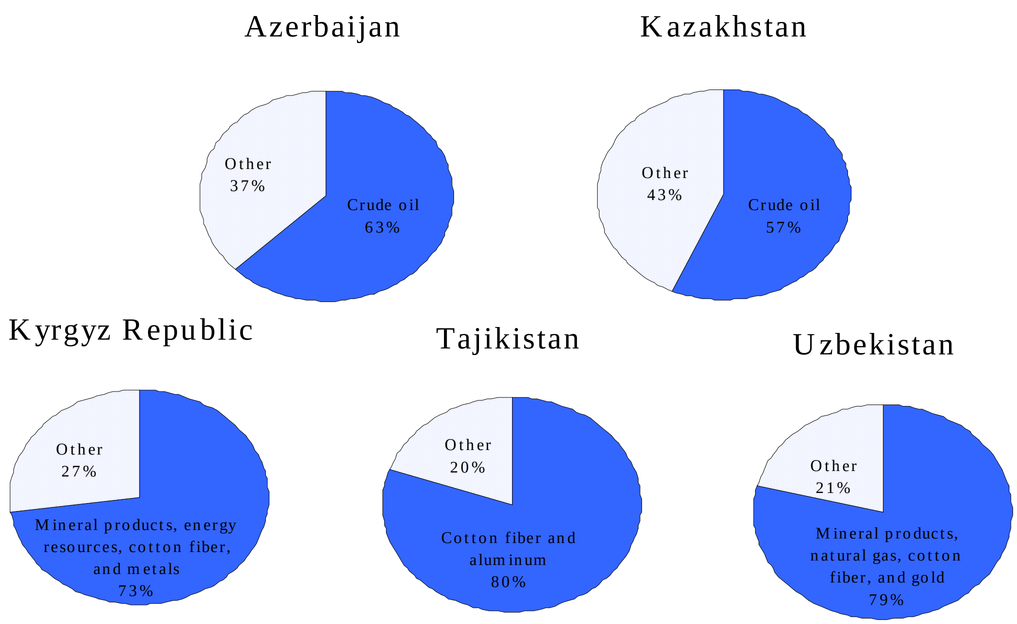


Sources: Government of CARs, IMF's Direction of Trade Statistics, and staff estimates.
[1]For Azerbaijan and Kazakhstan prices for crude oil, for Kyrgyz Republic prices for gold; for Tajikistan prices for aluminum and cotton fiber; and for Uzbekistan prices for gold and cotton fiber.

In terms of commodity composition, the CAR's exports has remained highly concentrated (Figure 3)**.** Indeed, the CARs' exports became even more dominated by a handful of primary commodities during 2000-2004. In 2004, crude oil accounted for 63 percent of Azerbaijan's exports and for 57 percent of Kazakhstan's exports; mineral products, energy resources, cotton fiber and precious and semiprecious metals comprised 73 percent of the Kyrgyz Republic's exports; the combined share of cotton fiber and aluminum was 80 percent of Tajikistan's exports; and the combined share of mineral products, natural gas, cotton fiber, and gold was 79.0 percent of Uzbekistan's exports. Heavy reliance on exports of a few primary commodities makes the

CARs vulnerable to abrupt swings in volatile world market prices for these commodities and complicates economic management.

Figure 3. Commodity Composition of Exports in CARs, 2004
(in percent)



Sources: IMF's Director of Trade Statistics, and staff estimates

At the same time, participation of the CARs in global value chains (GVCs), global production networks (GPNs) and related international trade in manufactured products remained very limited. Their limited participation in GVCs, GPNs and related trade in manufactured products means that the CARs derive relatively little benefits from trade in term of attracting foreign direct investment, gaining access to advanced technologies, and fostering sustained economic development.

Intra-regional trade among the CARs remained fairly small. Although it increased in absolute terms from US$1.6 billion in 1999 to US$3.4 billion in 2004, its share in total trade of the CARs fell from 8.4% to 6.6%. For Mercosur countries, intra-regional trade as a shares of their total trade amounted to 14.6 percent in 2003 with a range from 8 percent to 50 percent for individual members. For ASEAN countries, the share of intra-regional trade in total trade was 22 percent in 2001 and has remained relatively constant since then. For the newer members of ASEAN, the share of intra-ASEAN trade remained at more then 50 percent. Intraregional trade is quite important for the Kyrgyz Republic, Tajikistan and, to a lesser extent, Uzbekistan, but rather insignificant for Azerbaijan and Kazakhstan. One reason why intraregional trade among the CARs is small is that the degree of their trade complementarities is low. The trade complementarity between CARs and Mongolia is also low, whereas the trade complementarity between CARs and China is high.

III. REGIONAL INTEGRATION

Regional trade agreements (RTAs) have long been a prominent part of the region's policy agenda as the countries are small and geographically far removed from other markets. In this context, market integration is not only important for the gains from trade itself, but also for offering a more attractive investment environment for foreign investors. Consequently, CAREC countries participate in several regional cooperation agreements, which either deal exclusively with trade or have an important component focused on trade and investment (Attachment II).

Regional trade integration can be an effective—though economically second best—tool to expand trade and promote development in the CAREC countries. However, the balance between benefits and costs depends on the design of the agreements. Experience with regional integration around the world offers helpful lessons in this regard.

A. Best Practices

RTAs should be building blocks toward further trade liberalization and not used as tools to discriminate against excluded countries. RTAs may divert imports from nonmember sources whose production costs are lower to member suppliers whose costs are higher—the cost difference would be borne by the importing member (trade diversion effect). On the other hand, resources previously engaged in costly domestic production could be reallocated as a result of the RTA in the direction of countries' comparative advantage. This would increase economic welfare in RTA members (trade creation effect). Net trade-creation is more likely to dominate if the rate of protection vis-à-vis nonmembers is low to start with, or if the RTA partners agree on a schedule of swift reductions in their most-favored-nation (MFN) tariff over time.

Regional agreements in Central Asia should provide easy access to new members. An open approach to membership would represent a kind of "safety valve" against excessive trade diversion, by giving affected non-members the right to join the club.

Regional trade initiatives among CAREC members may need to be rationalized to avoid duplication of efforts and inconsistencies among the different agreements. The presence of overlapping initiatives can generate inconsistent rules. To take just one obvious example, membership in more than one customs union, such as Eurasian Economic Community (EAEC) and Common Economic Space (CES), is logically impossible. More generally, overlapping RTAs complicate trade, give rise to administrative discretion, offer scope for corruption, and might result in trade disputes.

RTAs should have comprehensive coverage of goods and services and ensure that high barriers as well as low barriers are removed or reduced. When only low tariffs are removed in a RTA, the benefits to the partners are smaller and resources are encouraged to move towards less efficient industries that continue to enjoy protection.

RTAs should also encompass "behind-the-border" reforms that encourage the development of a trade- and business-friendly environment. The aim should be to exploit the synergies of trade and other reforms. Recent RTAs in different parts of the world contain provisions relating to, inter alia, investment laws, intellectual property protection, product standards, competition policy, and government procurement.

RTAs should be transparent and have clear and liberal rules of origin (RoO). Restrictive RoO are an important reason why RTAs have often been ineffective at creating trade. The costs of administrative compliance, and the higher cost of regional inputs into production, can easily outweigh the advantage conveyed by the preference margin of the RTA.

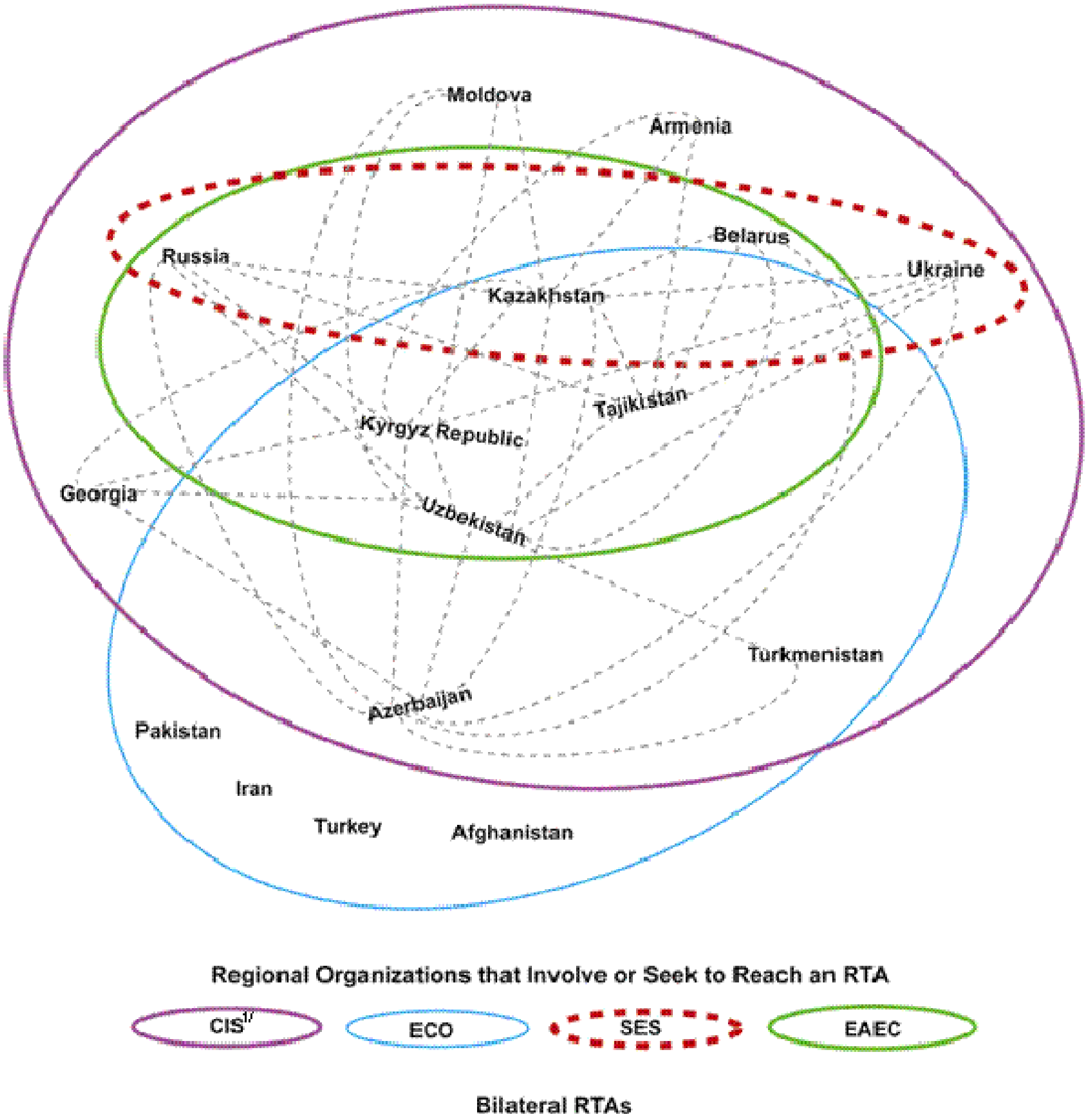
B. Issues with Regional Integration among CAREC Countries

The participation of the CAREC countries in the large number of often inconsistent regional economic integration schemes. A combination of often overlapping schemes has resulted in what the trade literature calls the "spaghetti bowl effect" (Figure 2). The large number of trade agreements, coupled with inconsistent rules, may in fact create additional barriers to trade, as it increases the scope for corruption, and creates uncertainty about the rules and distrust among the members. To produce tangible economic benefits, RTAs must first focus on practical issues of regional cooperation, such as reducing tariff and non-tariff barriers, removing impediments to transit trade, and strengthening cooperation in infrastructure projects.

The attitudes toward regional integration. In CARs, the attitudes toward regional cooperation and membership in regional organizations vary considerably. Moreover, substantial commitments to the implementation of many of these agreements are lacking and there has often been a failure to implement existing agreements. For example, the excise duties that Uzbekistan imposes on Kyrgyz goods are a violation of a trade agreement between the two countries. Furthermore, while efforts have been devoted to harmonizing tariffs and coordinating tariff offers, little progress has been made in reducing tariffs, or in substantially liberalizing the trading process. Thus, participation in various regional arrangements has so far had a limited impact on the trade regime and trade in CARs, and has not substantially increase trade liberalization.

Integration through custom areas or free trade areas. There are theoretic arguments supporting both options. Countries in a customs union may have an incentive to increase their protection by exploiting their monopoly power. In contrast, when forming a free trade area, countries can individually reduce their external protection and eliminate the harmful effects of trade diversion. Thus, free trade areas might lead to more liberalization than customs unions and present less obstacles to WTO accession. However, free trade areas must have RoO that prevent importers from bringing in goods through low-duty members and shipping them to countries where duties are higher. The rules may get very complex and can be used as a form of protectionism. If the difference between the MFN and the preferential tariff is high, incentives for corrupt practices may arise. Such incentives would not exist under customs unions. Therefore, customs union agreements may be less protectionist and, because they create fewer vested interests, more amenable to further liberalization.

Figure 4. "The Spaghetti Bowl Effect" of Regional Trade Agreements Involving Central Asian Republics
(As of January 2006)



Source: Draft Asian Development Bank Report: "Central Asia: Increasing Gains from Trade through Regional Cooperation in Trade Policy, Transport, and Customs Transit."

1/ In August 2005, Turkmenistan downgraded its membership in the CIS to the status of an "associated member".

IV. WTO ACCESSION

Many of the CAREC countries are still in the process of accession to the WTO. So far, only China, Kyrgyz Republic, and Mongolia are members of the WTO. While intending to pursue WTO membership and regional integration simultaneously, the priority of CARs has clearly been regional integration.

The main potential benefits for countries from joining the WTO are as follows:

- *Improved and predictable market access:* WTO members grant each other binding, non discriminatory most-favored nation access to their markets. This reduces uncertainty and transaction costs.
- *Access to binding dispute settlement:* Members can present a trade dispute before an impartial panel of experts, which decides if the policy in question 'nullified or impaired' WTO trade benefits for the complaining country.
- *External policy anchor:* Membership provides discipline to implement trade liberalization and domestic policy reforms. WTO commitments make it politically possible for the government to resist protectionist pressures.
- *A seat at the table:* Since the WTO is an international institution based on consensus without independent enforcement powers, WTO members negotiate rules that govern much of world trade.

Multilateral versus regional trade agreements

There is an overarching question about the trade-offs between short-term efforts to facilitate regional trade schemes (particularly the custom union of the Eurasian Economic Community) versus the long-term implications of multilateral free-trade facilitation. Thus, an important issue with regard to WTO accession is the proper sequencing with RTAs (in particular the customs unions).

Arguments in favor of joining the WTO before a customs union include the following:

- Customs union can be a stumbling block toward the process of further liberalization. Inefficient firms will lobby against the removal of preferential rates and exert pressure to avoid multilateral liberalization.
- Overlapping agreements can add uncertainty and undermine the transparency of the rules governing the multilateral trading system.
- The WTO provides a commitment mechanism that is easier to enforce than regional trade agreements. It can, in principle, impose penalties on countries that deviate from their commitments within the framework of the international trading system.

- Forming a customs union first could increase the overall level of protection. This is particularly likely if there is a country with greater bargaining power within the region and higher external tariff rates.

- Customs union membership can delay the WTO accession process. Finding a mutually acceptable position during the multilateral negotiations might be more time consuming because of the need to reconcile the interests of several constituencies.

The arguments for pursuing a customs union before acceding to the WTO, on the other hand, include the following:

- A country can increase its bargaining power in multilateral negotiations by entering first into a regional agreement with a common position toward sensitive issues (e.g., textile and agriculture), where developed countries still maintain a protectionist stance.

- By entering into multilateral negotiations as a region, rather than as a country, small states might face lower fixed costs of negotiation.

- Coordination among countries in a customs union is also meant to prevent them from undercutting each other during negotiations.

Estimation results of the two sequencing scenarios show that the welfare impact of each choice varies across countries. The impact depends on how the current tariff schedule of each country compares to the tariff schedule of the customs union. The welfare effects of joining the EAEC prior to accession are negative from a consumer standpoint in member countries whose tariffs are currently lower than those implied by the tariff schedule of the customs union. Net trade diversion also differs across members because of the difference in their current levels of protection.

In practice, participation in various regional trade arrangements has not facilitated WTO accession. In particular, the EAEC may have complicated the WTO accession process and trade reforms in general. It could be argued that coordination would strengthen the bargaining power if the countries involved acted with a common position. However, this is difficult given that each of the candidates is pursuing their own accession process at their own pace. The length of negotiations is most likely to increase because of the need to reconcile commitments under the EAEC with common terms of accession for WTO membership.

The liberal terms of Kyrgyz accession have been widely regarded by other EAEC members as having undermined their negotiation positions, given that the Kyrgyz tariff bindings are lower on average than the effective rate of protection prevailing in the other EAEC countries. The Kyrgyz Republic’s tariff bindings under the WTO are lower than the common external tariff under the EAEC. Either the EAEC members will need to lower the CET to make them compatible with the Kyrgyz Republic WTO commitments, or the Kyrgyz Republic will face inconsistencies between its WTO and EAEC commitments. In this case, the other WTO members can, in principle, ask for compensation.

CARs should give priority to accession to the WTO and regional cooperation in trade policy within the multilateral framework. Membership in an RTAs has so far had a limited impact on the trade regime in CARs and is unlikely to do so in the near future as governments in the CARs are reluctant to give up their policy autonomy. Meanwhile, the potential benefits of WTO membership for the CARs have increased significantly with China' accession in 2001, and will increase further as more of the CARs' neighbors (including Russia) join the organization. Moreover, WTO membership does not preclude regional cooperation in trade policy. Multilateral and bilateral development agencies can provide technical assistance in building institutions and capacity required for WTO accession.

V. TRADE BARRIERS IN CENTRAL ASIA

In Central Asia, there are manifold barriers to trade—that is, factors that impede trade among CARs (intra-regional trade) and between CARs and countries outside the region (extra-regional trade). While some of these trade barriers are imposed on the CARs by their geography, recent history, and trading partners, most of them are created by the CARs themselves.

A. Trade barriers relating to trade policy

Trade policies in the CARs vary widely in terms of restrictiveness, from very liberal in the Kyrgyz Republic and Tajikistan to fairly liberal in Azerbaijan and Kazakhstan to quite restrictive in Uzbekistan. Significant trade barriers pertaining to trade policies include prohibitions and licensing of exports and imports of certain commodities, registration of export-import contracts, tariffs and other taxes on imports, and taxes on exports.

- While all CARs prohibit or license exports and/or imports of certain goods to protect national security, public health, and environment, some CARs do so also for economic purposes.

- Some CARs use registration of export-import contracts as a means to regulate trade (Azerbaijan and Uzbekistan).

- Tariffs are fairly low and uniform in Azerbaijan, Kyrgyz Republic, and Tajikistan. Kazakhstan has a rather complex tariff schedule (with ten ad valorem and seven specific tariffs and some goods being subject to a combination of ad valorem and specific tariffs) but a relatively low non-weighted average rate (Table 1). Uzbekistan's tariffs schedule is not as complex as that of Kazakhstan, but its non-weighted average tariff rate is higher than that in the other CARs and the average tariff rate for all countries.

- A major problem with tariffs in CARs is that changes in tariff schedules are rather frequent and unpredictable (Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan). Also, there is escalation of tariffs—i.e., a rise in tariff rates with the degree of processing—and this is more pronounced in Azerbaijan, Kazakhstan, and Uzbekistan than in the Kyrgyz Republic and Tajikistan.

- Apart from explicit tariffs, some CARs impose other taxes on imports that are not levied on domestically produced goods or have higher rates for imported goods than for domestically produced goods (Azerbaijan, Kazakhstan, and Uzbekistan).

- Explicit taxes on exports are less common in Central Asia than taxes on imports. Taxes are imposed in Azerbaijan, on exports of metals and articles of non-ferrous metals and in Kazakhstan on a limited number of commodities when they are exported to the countries that are not members of the Eurasian Economic Community.

Table 1: Tariffs in Central Asian Republics[1]

(As of August 2005**)**

	Azerbaijan[2]	**Kazakhstan**[2]	**Kyrgyz Republic**	**Tajikistan**	**Uzbekistan**[2]
Number of tariff bands	6	10	5	4	4
Maximum rate (%)	15.0	30	15.0[3]	15.0	30.0
Non-weighted average rate (%)	5.7	7.4	5.1	7.5	14.6

Source: Draft Asian Development Bank Report: "Central Asia: Increasing Gains from Trade through Regional Cooperation in Trade Policy, Transport, and Customs Transit."

[1] These tariffs apply to imports from the countries to which the CAR concerned has given the most favored nation status but with which it does not have a preferential trade agreement.
[2] Ad valorem tariffs only. There are also specific and combined tariffs.
[3] Excluding a 30% seasonal tariff on refined sugar.

B. Trade Barriers Relating to Transport and Transit

A significant barrier to trade in Central Asia is relatively high transport costs and long and often unpredictable transit times for international shipments to and from the region (Table 2). While this is due in part to the region's land-locked and remote location, there are a number of "manmade" contributing factors.

- Transport links between the CARs and non-FSU countries are still poorly developed.

- Much of the existing roads are in poor condition.

- The market for transport services is underdeveloped and the quality of services is relatively poor. There is limited competition in the markets for rail and air services, which are dominated by state-owned companies. Road transport is mostly comprised of small and micro firms, with no well-integrated regional transport companies.

- Transit through neighboring countries is costly and time consuming, especially for road transport.

Table 2: Estimated Transport Costs in Merchandise Exports and Imports of Central Asian Republics, 2003

	Transport Costs of Exports		Transport Costs of Imports	
	In % of exports	In million US dollars	In % of imports	In million US dollars
Azerbaijan	8.0	207.4	7.0	183.8
Kazakhstan	10.0	1292.7	8.0	583.0
Kyrgyz Republic	13.0	75.6	10.0	72.0
Tajikistan	14.0	111.6	10.0	88.0
Uzbekistan	12.0	382.8	8.0	206.0

Sources: Faye et al. (2004), Ojala et al. (2004) and staff estimates.

C. Trade Barriers Relating to Border Crossing and Customs Clearance

As the CARs established national borders and increasingly tightened border controls following the break-up of the Soviet Union, difficulties with border crossing became a serious obstacle not only for transit trade, but also for cross-border trade and movements of people for business and personal purposes.

- Difficulties with border crossing and other obstacles to cross-border trade are evident in significant price variations across CARs.

- Customs rules and procedures in the region are generally non-transparent, complex, and bureaucratic, giving customs officials too many discretionary powers. Moreover, they change frequently and vary significantly across countries. Most customs declarations are subjected to physical check of the consignment, delays in clearing goods through customs are common, and unofficial payments are often needed to expedite it.

- The situation is exacerbated by excessive certification requirements and weak standards institutions.

D. Other Major Trade Barriers

- In most CARs, there are barriers to market entry into international trade. These include registration and high minimum capital requirements for international trading activity, mandatory sales of exportable goods to certain companies, excessive checks and controls of new market entrants by various government agencies. The barriers to market entry weaken competition in trade, enable trading companies with a monopoly position to charge higher prices for their services, make exports less competitive, increase costs of imports, and ultimately have an adverse impact on trade.

- Unfavorable payment and foreign exchange regulations currently in place in some CARs create additional impediments to trade.

- The quality of institutions in CARs is quite low. Notably, laws and regulations are not always transparent and properly enforced, protection of property rights and enforcement of contracts are weak, and corruption is a serious problem.

- Underdeveloped financial sectors, and a lack of marketing companies and skills also constitute obstacles to trade. In most CARs, financial services and instruments facilitating international trade, such as short-term credits, insurance, letters of credit, and bills of exchange, are not readily available. Businesses in Central Asia have limited information about export and import opportunities existing in other countries, while businesses in other countries often lack information about similar opportunities existing in Central Asia.

While most of the trade barriers listed above are present in all CARs, their significance varies across the countries. A summary assessment of the significance of the trade barriers discussed for each of the CARs are provided in Table 3.

E. Effects of Trade Barriers

Apart from constraining growth of officially recorded trade, the trade barriers discussed above have numerous other negative effects.

- **They encourage illegal trade.** Faced with restrictions or high taxes, traders often resort to illegal ways of conducting trade, such as smuggling and under-invoicing. As a result, a substantial proportion of trade in the region goes unrecorded and the governments lose a considerable part of proceeds from taxes on international trade.

- **They fuel corruption** by increasing incentives for smuggling and under-invoicing and creating opportunities for rent-seeking**.** Traders sometimes bribe government officials to obtain licenses, expedite registration of export-import contracts, facilitate border crossing and customs clearance of goods, and enable smuggling or under-invoicing.

Table 3. Significance of Trade Barriers for Central Asian Republics

	Azerbaijan	Kazakhstan	Kyrgyz Republic	Tajikistan	Uzbekistan
Quantitative restrictions and licensing	Somewhat significant	Somewhat significant	Somewhat significant	Somewhat significant	Very significant
Registration of export-import contracts	Not significant	Not significant	Not significant	Not significant	Very significant
Tariffs and other taxes on imports	Somewhat significant	Somewhat significant	Not significant	Not significant	Very significant
Explicit taxes on exports	Somewhat significant	Somewhat significant	Not significant	Not significant	Not significant
High transport costs and long and unpredictable transit times	Somewhat significant	Somewhat significant	Very significant	Very significant	Somewhat significant
Difficulties with border crossing	Somewhat significant	Somewhat significant	Somewhat significant	Somewhat significant	Very significant
Difficulties with customs clearance	Very significant	Very significant	Very significant	Very significant	Very significant
Barriers to market entry into international trade	Somewhat significant	Not significant	Not significant	Not significant	Very significant
Unfavorable foreign exchange and payment regulations	Not significant	Not significant	Not significant	Somewhat significant	Somewhat significant
Low quality of institutions	Very significant	Very significant	Very significant	Very significant	Very significant
Underdeveloped financial sector	Somewhat significant	Not significant	Somewhat significant	Somewhat significant	Somewhat significant
Lack of marketing skills	Somewhat significant	Somewhat significant	Somewhat significant	Somewhat significant	Somewhat significant
Tariff and non-tariff barriers to imports from CARs imposed by other countries	Somewhat significant	Somewhat significant	Somewhat significant	Somewhat significant	Somewhat significant
Agricultural subsidies in the US and the EU	Very significant	Very significant	Very significant	Very significant	Very significant

Not significant   Somewhat significant   Very significant

Source: ADB staff assessments.

- **They also affect the composition of trade**. Notably, long transit times impede trade in perishable goods more than trade in none perishable products and have a greater negative impact on exports of manufactured products than of primary commodities.

- **They distort domestic relative prices,** which in turn have negative consequences.

  - They usually afford import-competing products a much higher degree of effective protection than the corresponding tariffs suggest.

  - They shift resources from export-oriented to import-competing sectors and redistribute income from the general public and export-oriented sectors to import-competing sectors, from rural to urban population, and from the poor to the rich.

  - They result in sub-optimal allocation of resources and inefficient utilization of scarce factors of production.

  - They lead to welfare-reducing economic growth, which occurs when output growth is generated by inefficient import-competing sectors that take away resources from efficient export-oriented sectors.

Simulations based on computable general equilibrium (CGE) models of Kazakhstan and the Kyrgyz Republic suggest that potential benefits of reducing trade barriers are considerable even for the CARs with a relatively liberal trade regime. A reduction in trade barriers would provide a major boost to trade, aggregate output, and consumption. While both exports and imports would increase, the former would increase more than the latter, resulting in an improvement in the trade balance. The overall consumer price level would decline, and the poor would benefit more than the rich.

F. Measures aimed at reducing existing barriers to transit trade

Following the discussions at its third meeting, TPCC recommended the following measures aimed at reducing the existing barriers to transit trade in Central Asia, which were endorsed by the Ministers in November 2005:

(i) Ensuring the control of customs officers and other agencies regarding full compliance with the TIR Convention; China will take steps to accelerate TIR accession and promote the TIR Customs Transit System in the region.

(ii) Reduction in the rate of charges for customs convoy under the national transit systems in appropriate countries with simultaneous reductions in the list of goods subject to such convoys (concrete proposals will be developed).

(iii) Reduction in the cost of non-reciprocal road transport permits to levels that will cover related costs without discouraging transit trade.

(iv) Abolition of all other charges and fees on entry (transit) of foreign carriers.

(v) Reduction of the cost of entry visas for foreign road carriers and foreseeing the issuance of visas to foreign road carriers at international pass points in a simple way.

(vi) Unification of transport, customs, and border documentation in order to harmonize procedures of control at and to minimize time to pass at the border, and

(vii) Taking measures to prevent and eradicate cases of unofficial payments from road carriers in transit.

Ministers also agreed that the country delegates to the TPCC should take responsibility for monitoring the implementation of these measures related to barriers to transit trade. Thus, each country delegation will report to the TPCC on the status of implementation of the measures in its country, and the TPCC will in turn produce a consolidated report on their implementation. While these measure will be important to promote trade, they are only a start in dismantling trade barriers.

VI. Conclusions and Recommendations

CAREC member countries need to adopt more open trade regimes to facilitate both intra- and inter-regional trade. In particular:

(i) The trade barriers, such as restrictions on cross-border trade, that fuel smuggling and corruption and are ineffective in protecting domestic producers from international competition need to be dismantled expeditiously. So do the trade barriers, such as licensing, the barriers to market entry into international trade; foreign exchange and payment regulations; and the prohibition of exports of a particular commodity;

(ii) The quantitative restrictions that are intended to protect domestic producers from international competition or ensure availability of certain goods at the domestic market at relatively low prices need to be converted into explicit tariffs and export taxes, as appropriate, in the short run and reduced as part of trade policy liberalization in the medium run. So do implicit tariffs in the form of various taxes on imports that are not levied on domestically produced commodities or have higher rates for imported than for domestically produced goods;

(iii) The CARs need to cooperate with each other and neighboring countries to reduce barriers to trade relating to transport, transit, border crossing, customs clearance, weak institutions, underdevelopment of the financial sector, and the lack of marketing skills by, in particular, simplifying and harmonizing border crossing and customs rules and procedures developing a relatively simple regional transit system, and sharing knowledge and best practices in border management, customs modernization, financial sector development, and institutional building;

(iv) There is a need to reassess participation in a large number of sometimes conflicting regional economic integration schemes. The large number of trade arrangements in the region and the plethora of inconsistent rules of origin represent additional barriers not only because of increased scope for corruption but also because uncertainty about rules creates disputes, retaliation, and a climate of distrust;

(v) The CARs that are not yet members of the WTO should give precedence to accession to this organization and multilateral trade liberalization within the WTO framework over trade liberalization within a regional trade arrangement. Liberalization of a trade regime needs to be supported by other structural reforms aimed at enhancing the economy's competitiveness and ensuring adequate supply response to trade liberalization. Sound macroeconomic policies are essential to maintaining the macroeconomic stability during and after trade liberalization.

ATTACHMENT I

PAPERS PREPARED FOR THE TPCC

Background papers that were prepared to facilitate discussions in the TPCC included:

- *Trade Policy Issues in the Central Asian Republics (IMF).* This paper provided a summary of bilateral trade relations, regional and other trade agreements, the issue of establishing a central Asian customs area or free trade zone, individual CAREC country progress toward WTO accession, and the issue of sequencing WTO accession and further deepening of regional trade relations.

- *Trade Barriers in Central Asia (ADB)*. This paper focused on barriers in trade policy (quantitative restrictions, registration requirements for exports or imports, tariffs, and other trade taxes), barriers related to transport and transit, barriers related to border crossing and customs clearance, and other trade barriers. The paper also included an estimate of the effects of these trade barriers, and as an example of the benefits of removing these barriers the paper presented estimates of the impact of a 50 percent reduction in trade margins in Kazakhstan and the Kyrgyz Republic on real GDP, inflation, consumption, investment and trade levels.

- *Comparative Advantage in International Trade for Central Asia (World Bank)*. The paper notes the difficulties in unambiguously identifying areas of comparative advantage in a dynamic world economy, and thus argues against any attempts to directly subsidize industries that are deemed to have comparative advantage. However, it argues that having some indication of where a country's comparative advantage may lie can help governments prioritize infrastructure investments and other market-friendly policies. In this context, the paper presents some preliminary and partial analysis of possible areas of comparative advantage, utilizing the ITC Trade Map and Product Map.

- *Regional Trade Integration: Considerations for the CAREC Countries (IMF*). This paper summarizes best practices in designing regional trade agreements and touches briefly on the issues of WTO accession and regional trade integration. It was circulated to the TPCC together with an IMF Working Paper on *Regional Trade Integration and WTO Accessions: Which is the Right Sequencing? An Application to the CIS.* The IMF Working Paper analyzes the appropriate sequencing between WTO accession and implementation of the Eurasian Economic Community (EAEC) customs union. It concludes that welfare will be greater if WTO accession precedes the EAEC Customs Union.

- *Barriers to Transit Trade in Central Asia (ADB).* This paper assessed barriers related to customs transit, transport and governance problems. Based on this analysis, the paper made a number of concrete recommendations for policy actions which CAREC member countries could take to ease or eliminate these barriers.

ATTACHMENT II

REGIONAL COOPERATION AGREEMENTS AND INITIATIVES IN CENTRAL ASIA

- Economic Cooperation and Organization, 1992: Afghanistan, Islamic Republic of Azerbaijan, Islamic Republic of Iran, Kazakhstan, the Kyrgyz Republic, Pakistan, Tajikistan, Turkey, Turkmenistan, and Uzbekistan.

- Black Sea Economic Cooperation, 1992: Armenia, Azerbaijan, Georgia, Moldova, the Russian Federation, and Ukraine.

- Energy Charter Treaty, 1994: signed by all Central Asian countries and most European countries.

- Central Asia Cooperation Organization (CAREC), 1997: Azerbaijan, People's Republic of China (focusing on Xinjiang Uygur Autonomous Region), Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Uzbekistan.

- CIS Free Trade Agreement, 1994: Armenia, Belarus, Georgia, Moldova, Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan, Ukraine, and Uzbekistan. It has not been ratified by a number of states.

- Central Asia Cooperation Organization (CACO), 2002: Kazakhstan, the Kyrgyz Republic The Russian Federation, Tajikistan and Uzbekistan.

- GUUAM, 1997: Azerbaijan, Georgia, Moldova, Ukraine, and Uzbekistan.

- Eurasian Economic Community, signed in 2000, ratified in May 2001. It includes Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation, and Tajikistan.

- Shanghai Cooperation Organization, 2001: China, Kazakhstan, the Kyrgyz Republic, the Russian Federation, and Tajikistan.

- Common Economic Area, September 2003: draft agreement between Belarus, Kazakhstan, the Russian Federation, and Ukraine.

- Agreement on Partnership and Cooperation between Moldova and the EU, 1994. It became effective in 1998.

- Agreement on Partnership and Cooperation between the EU and Uzbekistan, 1996. The main goal is economic cooperation.

- Agreement on Partnership and Cooperation between the EU and the Russian Federation, 1998.

- Agreement on Partnership and Cooperation between the EU and Turkmenistan, 1998.

- Balkan Stability Pact, 1999: signed by Albania, Bosnia and Herzegovina, Bulgaria, Croatia, former Yugoslav Republic of Macedonia, Moldova, Romania, Turkey and the Federal Republic of Yugoslavia. In 2002 it admitted the Czech Republic, Poland and the Slovak Republic.

- Caspian Sea Oil and Gas agreements, November 1999: Signed by Azerbaijan, Georgia, Kazakhstan, Turkey, and Turkmenistan concerning pipeline projects for the export of Caspian Sea oil and gas to world markets via Turkey, bypassing the alternative routes across Russia and Iran. The two agreements envisage the construction of an oil pipeline from Baku in Azerbaijan to Ceyhan in southeast Turkey, and a Transcaspian gas pipeline linking Turkmenistan with northeast Turkey via the Caspian seabed and the Caucasus Mountains. The agreements also appear to resolve a border dispute between Azerbaijan and Turkmenistan over ownership of three Caspian oilfields linked to pipeline projects.

- The Silk Road agreement, September 1998. All the CIS countries (excluding the Russian Federation and Turkmenistan) along with Bulgaria, Romania and Turkey, signed the agreement which provides for the coordinated development of transport links between China and Europe, and the regulation of transport tariffs and custom procedures across the Caspian and Black Seas.