3
Barriers to Trade in Central Asia

The recent merchandise trade performance of the CARs has been adversely affected by the presence of numerous barriers to trade in Central Asia—that is, factors that obstruct exports from and/or imports to the CARs. Some of these trade barriers (such as relatively weak trade links between the CARs and non-FSU countries) are a legacy of the FSU while others (e.g., barriers to cross-border movements of goods, people, and transport equipment among the CARs) emerged after the breakup of the FSU. Some of them—like additional transport costs and transit times needed for international shipments to and from the CARs due to their landlocked location and difficult topography—are beyond their control. However, others—such as policy barriers created by the CARs and their trading partners—can be reduced by the CARs through unilateral or collective action.

This chapter identifies some of the more important barriers to trade in Central Asia that the CARs can potentially lower through regional cooperation in trade policy, transport, and customs transit.[1] It also highlights costs of these trade barriers, including their adverse effects on the recent trade merchandise performance of the CARs.

3.1 Barriers Pertaining to Trade Policy

The CARs had very similar trade policy regimes at the time of their independence, but these have diverged significantly since then. The Kyrgyz Republic liberalized its trade policy rapidly in the first half of the 1990s (see Figure 3.1). Kazakhstan also made considerable progress in trade liberalization in the first half of the 1990s, but this was partly reversed in the late 1990s. Azerbaijan liberalized its trade policy fairly fast after concluding a ceasefire agreement with Armenia in 1994, as did Tajikistan after the end of the civil war in 1997. Uzbekistan has made relatively limited headway in trade liberalization, with a significant reversal in the mid-1990s. Consequently, trade policy regimes in the CARs vary widely today from very liberal in the Kyrgyz Republic to fairly liberal in Azerbaijan, Kazakhstan, and Tajikistan, to quite restrictive in Uzbekistan.

Tariffs are fairly low and uniform in Azerbaijan, Kyrgyz Republic, and Tajikistan (see Table 3.1). Kazakhstan has a rather complex tariff schedule with a large number of tariff bands and a high maximum tariff rate, although its nonweighted average tariff rate is not high. Uzbekistan has a complex tariff

[1] The chapter does not discuss the barriers to trade in Central Asia (such as difficulties with customs clearance of goods being exported from or imported to the CARs and restrictions on domestic marketing of exportable and imported goods) that cannot be reduced through regional cooperation in trade policy, transport, and customs transit.

Figure 3.1: European Bank for Reconstruction and Development's Index of Foreign Exchange and Trade Liberalization for the Central Asian Republics, 1991–2005

European Bank for Reconstruction and Development's (EBRD's) Index of Foreign Exchange and Trade Liberalization ranges from 1.0 to 4.3, with 1.0 denoting widespread import and/or export controls or very limited access to foreign exchange and 4.3 denoting standards and performance norms of advanced industrial economies.

Source: EBRD (2001 and 2005)

Table 3.1: Tariffs in the Central Asian Republics[a]
(As of 1 January 2006)

	Azerbaijan[b]	Kazakhstan[b]	Kyrgyz Republic	Tajikistan	Uzbekistan[b]
Number of tariff bands	6	10	5	4	4
Maximum rate (%)	15.0	100.0	15.0[c]	15.0	30.0
Nonweighted average rate (%)	5.7	7.4	5.1	7.5	14.5

Note:
[a] These tariffs apply to imports from the countries to which the Central Asian republic concerned has given the most favored nation status but with which it does not have a preferential trade agreement.
[b] Ad valorem tariffs and ad valorem components of combined tariffs. There are also specific tariffs.
[c] Excluding a 30% seasonal tariff on refined sugar.

Source: Authors' estimates based on the tariff schedules of the Central Asian republics.

schedule and a relatively high nonweighted average tariff rate.[2] A serious problem with tariffs in Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan is that changes in tariff schedules are rather frequent and unpredictable. Also, there is an escalation of tariffs—i.e., a rise in tariff rates with a degree of processing—in all the CARs. This is more pronounced in Azerbaijan, Kazakhstan, and Uzbekistan than in the Kyrgyz Republic and Tajikistan.

[2] In Uzbekistan, tariffs, the value-added tax, and excise taxes are levied on imports by legal entities only. Imports by individuals are subject to a unified tax on imports, the rate of which is 26% for flour, 40% for other food products, and 70% for nonfood products. The rate of the unified tax is lower than the combined rate of the tariff, the value-added tax, and the excise tax for most food products, but higher than that for most nonfood products.

In addition to explicit tariffs, some of the 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.[3] In Azerbaijan and Kazakhstan, the coverage of excise taxes on imported and domestically produced goods are identical, but the rates of the former are considerably higher than those of the latter for some commodities. In Uzbekistan, excise taxes are levied on a wide range of imported, but not domestically produced, consumer products. These include ice cream (subject to a 200% excise tax), mineral water (100%), most types of juices (70%), poultry meat (70%), cheese (50%), yogurt (50%), plastic tableware and kitchenware (50%), and soap (20%).[4] Certain commodities, such as construction materials, are subject to the value-added tax (VAT) when imported, but exempt from this tax when produced domestically.[5] Furthermore, nonfood products brought to Uzbekistan for commercial purposes from neighboring countries without a certificate of origin, but not necessarily originating in those countries, are subject to a 20% surcharge.

Explicit taxes on exports are less common in Central Asia than taxes on imports. In Azerbaijan, exports of metals and articles of nonferrous metals (with the exception of aluminum products) are subject to an export tax. Further, 25% of the difference between the export price and the domestic wholesale price of products with regulated domestic prices is to be transferred to the state budget. Kazakhstan levies export taxes on a limited number of commodities when they are exported to non-EAEC countries.[6]

While all the CARs prohibit or license exports and/or imports of certain goods to protect national security, public health, and environment, some of them do so also for economic purposes. In particular, Azerbaijan prohibits exports of scrap metals to ensure their availability for domestic consumption. Uzbekistan prohibits imports of packed tea in an effort to increase demand for domestically produced packed tea. Uzbekistan also prohibits exports of flour, meat, sugar, vegetable oil, and a number of other—mostly consumer—products to ensure their availability in the domestic market at relatively low prices. For the same reason, Kazakhstan temporarily prohibits exports of diesel fuel and fuel oil during harvesting and heating seasons, respectively. Licensing of certain exports and imports—such as imports of tobacco and alcoholic beverages to Azerbaijan and Tajikistan, exports of scrap of nonferrous metals from the Kyrgyz Republic, and exports of precious metals and their scrap from Uzbekistan—appears to be primarily intended to preserve the existing monopolies.

In addition to taxes and quantitative restrictions on imports and exports, some CARs use other policy tools as an instrument of trade policy. Notably, Uzbekistan appears to continue using restrictions on access to foreign exchange in regulating imports even though it *de jure* introduced full convertibility of its national currency for current international transactions in October 2003. It is not always possible to purchase foreign exchange through official channels even for bona fide imports. And it is generally more so for imports of consumer goods than for imports of capital goods. Uzbekistan also uses restrictions on cross-border movements of people and transport equipment to restrict imports. In 2002, for example, it tightened rules and procedures for movements of people and vehicles across Kazakh-Uzbek and Kyrgyz-Uzbek borders in an apparent effort to restrict imports of consumer goods from Kazakhstan and the Kyrgyz Republic.

[3] The difference between the rates of these taxes on imported and domestically produced goods constitutes an implicit tariff.

[4] In what appears to be a policy inconsistency, Uzbekistan tries to lower the domestic price for poultry meat by prohibiting its exports and simultaneously attempts to raise its domestic price by levying a 50% excise tax on imported poultry meat.

[5] In Azerbaijan and Uzbekistan, some commodities are exempt from the VAT when they are imported, but subject to it when produced domestically. This constitutes a negative implicit tariff on these commodities.

[6] These include scraps of ferrous metals, whose exports to the European Union (EU) are also exempt from the export tax.

Besides the trade barriers relating to trade policy in the CARs, there are also significant barriers to trade in Central Asia induced by trade policy of countries outside the region. Most notably, exports of agricultural products from the CARs to developed countries face relatively high tariffs. Large export and other subsidies that developed countries provide to their farmers further impede imports of agricultural products to these countries. Cline (2005) estimates that when both tariff and the tariff-equivalent of domestic subsidies are taken into account, agricultural protection amount to about 20% in the US, 50% in Canada and EU, and 80% in Japan. Furthermore, countries outside the region occasionally impose or threaten to impose antidumping duties on imports from the CARs. The US, for example, charges antidumping duties on imports of silicomanganese from Kazakhstan and the EU imposes quotas on imports of steel from Kazakhstan. All of the CARs, with the exception of Kazakhstan, have a nonmarket economy status in developed countries, which exposes their exports to those countries to relatively restrictive anti-dumping measures.

3.2 Barriers Pertaining to Transport and Customs Transit

All the CARs are landlocked and situated far from major international seaports and developed country markets. In addition, the CARs have a difficult topography that complicates their transport links with the other parts of the world, particularly South Asia. The situation is exacerbated by deficiencies of the CARs' transport networks, high costs and low quality of transport and logistics services in the region, and difficulties with movements of goods and transport equipment across borders and through the territories of the CARs and neighboring countries. The result is generally high transport costs and long and unpredictable transit times for international shipments to and from the CARs.

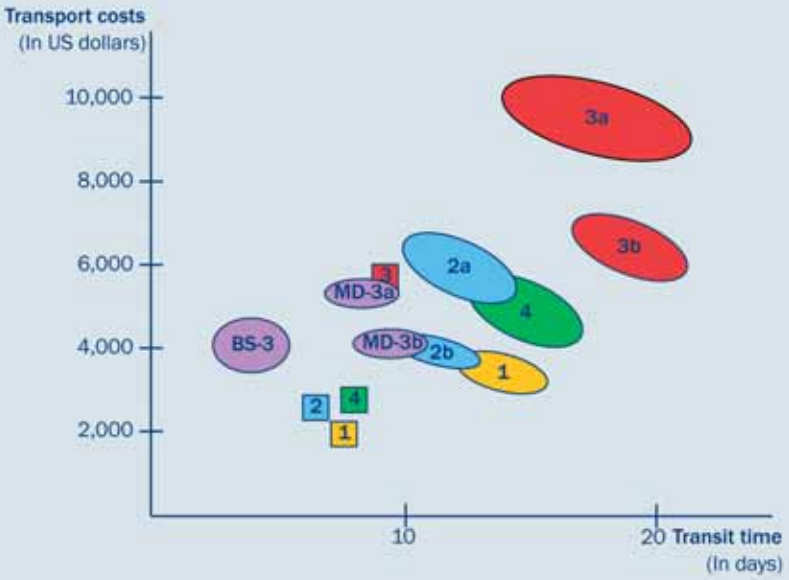
Figures 3.2 and 3.3 compare the actual transport costs and transit times for shipments by road and by rail between the four CARs (Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan) and selected countries outside the region with the corresponding transport costs and transit times in the "ideal world" (i.e., a world with balanced transport flows, competitive markets for transport services, smooth border crossing, low transit fees, and no visa problems and unofficial payments). The figures show that the actual transport costs are much higher and the actual transit times are much longer for shipments to and from the CARs than those in the "ideal world."[7] Moreover, transit times for international shipments by road for longer distances (e.g., shipments from the Benelux countries) vary more than those for shorter distances (e.g., shipments from Istanbul). This indicates that transit times for international shipments become increasingly unpredictable as the distances involved increase.

Figures 3.2 and 3.3 also demonstrate the significant transport costs and transit time disadvantage faced by the CARs compared with the Baltic States and Moldova. Transport costs for shipment by road between the CARs and the Benelux countries are 1.5–2.5 times as high as those for road shipments between the Baltic States and Moldova, on the one hand, and the Benelux countries, on the other, while transit times are 2.0–3.0 times as long. Even for shipments by rail between the CARs and Moscow, transport costs are generally higher and transit times are significantly longer than those for rail shipments between the Baltic States and Moldova, on the one hand, and Moscow, on the other.

Finally, Figures 3.2 and 3.3 show that there is an asymmetry in transport costs for international shipments between Central Asia and Europe. For example, it costs $8,500–$10,500 to ship a truckload of cargo from the Benelux countries to Central Asia, and only $6,000–$7,000

[7] Only for shipments by rail and by sea from Central Asia to the East coast of the PRC through Bandar Abbas, Iran, the actual transport cost is lower than the transport cost in the "ideal world." The reason is that transport flows from the PRC to Middle East, most of which goes through Bandar Abbas, exceed transport flows in the opposite direction and transport costs for shipments from Bandar Abbas to the PRC are relatively low.

Figure 3.2: Transport Costs and Transit Times for Shipments by Road between the Central Asian Republics (Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan) and Selected Countries, Spring 2005



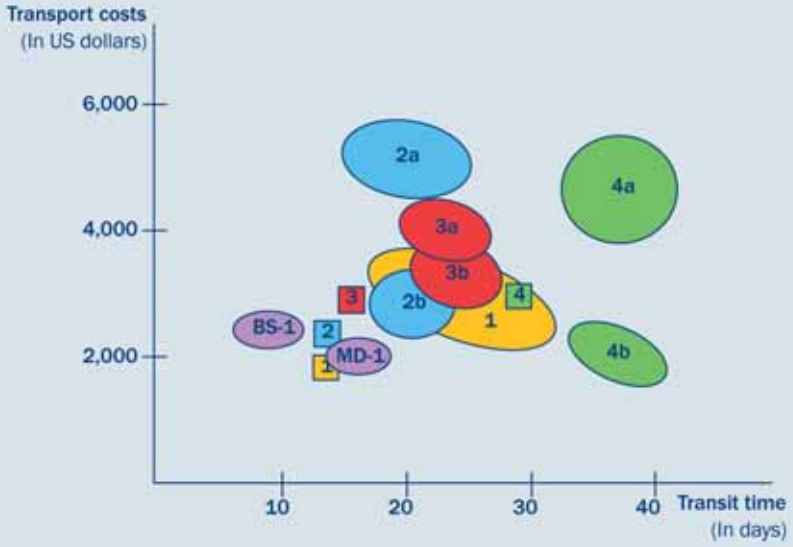
Legends:	Actual transport costs and transit time
	Transport costs and transit time in the "ideal world" (i.e. a world with balanced transport flows, competitive markets for transport services, smooth border crossing, low transit fees, and no visa problems and unofficial payments).
1	For a shipment by a local truck to Moscow;
2	For a shipment by a Turkish truck (a) from Istanbul and (b) to Istanbul;
3	For a shipment by a European truck (a) from the Benelux countries (Belgium, Netherlands, and Luxemburg) and (b) to the Benelux countries;
4	For a shipment by a local truck to and from Finnish border;
BS-3	For shipments between the Baltic States and the Benelux countries;
MD-3	For shipments (a) from the Benelux countries to Moldova and (b) from Moldova to the Benelux countries.

Source: Data collected by the authors.

to ship in the opposite direction. In the "ideal world," shipments would cost $5,500–$6,000 in either direction. This is due to the particular commodity composition of trade between Central Asia and Europe. Exports from Central Asia to Europe consist mostly of primary commodities transported by rail and through pipelines, while imports from Europe to Central Asia consist mostly of manufactured products transported by road and by air.[8]

[8] According to freight forwarders, only a small fraction of trucks carrying goods from the EU to Central Asia return with cargo despite the relatively low costs of shipments from Central Asia to Europe. This is not only due to the relatively small amount of exports from Central Asia to the EU that need to be transported by road, but also because many road transporters refuse to carry a less-than-truckload of consolidated cargo to avoid excessive and cumbersome border crossing and transit procedures. As a result, a lot of cargo capacity is wasted. The total loss due to this problem is estimated at around $300 million per year.

Figure 3.3: Transport Costs and Transit Times for Shipments by Rail between the Central Asian Republics (Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan) and Selected Countries, Spring 2005



Legends:

- Actual transport costs and transit time
- Transport costs and transit time in the "ideal world" (i.e. a world with balanced transport flows, competitive markets for transport services, smooth border crossing, low transit fees, and no visa problems and unofficial payments).
- 1 For a shipment of a full wagon or a 40-foot container from and to Moscow by rail;
- 2 For a shipment of a 40-foot container (a) from Istanbul and (b) to Istanbul by rail and by sea;
- 3 For a shipment of a 40-foot container (a) from the Benelux countries and (b) to the Benelux countries by rail;
- 4 For a shipment of a 40-foot container (a) the East coast of the People's Republic of China (PRC) by rail over land and (b) to the East coast of the PRC by rail and sea via Bandar Abbas;
- BS-1 For shipment between the Baltic States and Moscow;
- MD-1 For shipments between Moldova and Moscow.

Source: Data collected by the authors.

Table 3.2 presents estimates of transport costs of merchandise exports and imports of the CARs in 2003. According to these estimates, transport costs in the value of exports ranged from 8.0% in Azerbaijan to 14.0% in Tajikistan, and the share of transport costs in the value of imports ranged from 7.0% in Azerbaijan to 10.0% in the Kyrgyz Republic and Tajikistan. Using reference values for similar countries, it is estimated that total logistics cost made up 16–19% of the total value of exports and imports in the CARs. Excluding exports of primary commodities and imports of heavy machinery and equipment, for which transport costs are relatively low, transport costs comprised an estimated 11–16% and logistics costs accounted for more than 20% of the total value of exports and imports in the CARs. By comparison, transport costs made up 8.4% of the value of imports in Asia as a whole and 6.1% of the value of imports in the world at large in 2001. In EU countries, logistics costs in manufacturing generally

Table 3.2: Estimated Transport Costs in Merchandise Exports and Imports of the Central Asian Republics, 2003

	Transport Costs of Exports		Transport Costs of Imports	
	In percent of exports	In million US dollars	In percent of imports	In million US dollars
Azerbaijan	8.0	207.4	7.0	183.8
Kazakhstan	10.0	1,292.7	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

Source: Faye et al. (2004), Ojala, Naula, and Queiroz (2004), and the authors' estimates.

comprise less than 10% of the value of products and transport costs are only 1/3 of logistics costs.

3.3 Costs of Trade Barriers

The presence of the above trade barriers has adversely affected the recent merchandise trade performance of the CARs in several ways. First, they have constrained growth of trade. Although in all the CARs exports and imports expanded considerably in 2000–2004 and the actual ratio of exports plus imports to GDP exceeded the estimated potential level in 2004, cumulative growth of exports in the Kyrgyz Republic, Tajikistan, and Uzbekistan and the cumulative growth of imports in the Kyrgyz Republic and Uzbekistan were lower than those in many other countries, including the PRC and Mongolia (two other CAREC member countries), and the world as a whole (see Figure 3.4). 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.

Second, trade barriers have adversely impacted on the direction of trade in the CARs. In particular, relatively high transport costs and long and unpredictable transit times for international shipments to and from the CARs have hindered reorientation of their trade from FSU to non-FSU countries, which partly explains why the CARs generally "overtrade" with other CIS countries but "undertrade" with most East and South Asian and Western European countries.

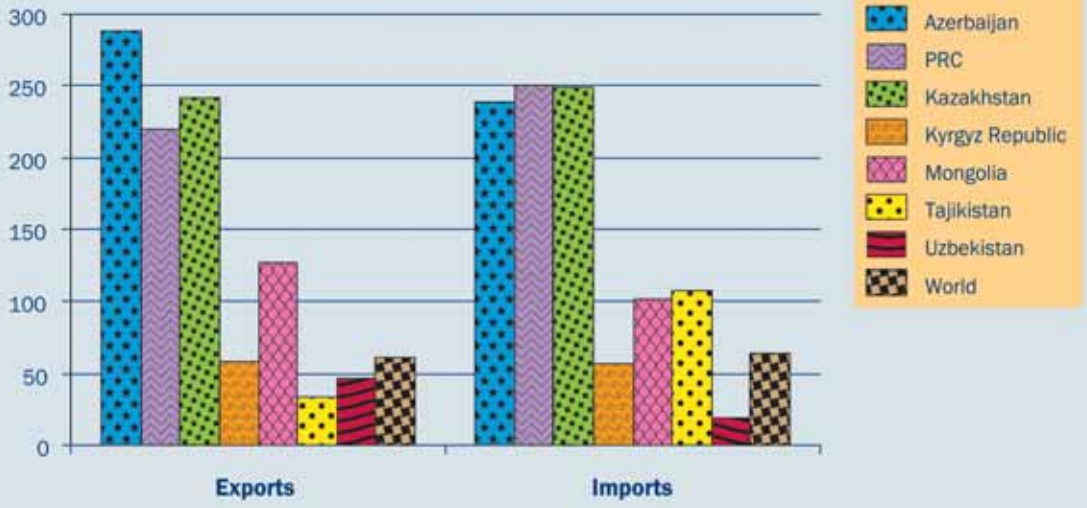
Third, trade barriers have had an adverse impact on the composition of trade in the CARs. Notably, long and unpredictable transit times have constrained exports of time-sensitive goods and manufactured products with relatively low profit margins more than exports of primary commodities, which are not time-sensitive and can be transported in bulk at relatively low costs. This is one reason for the limited participation of the CARs in GPNs and related international trade in manufactured products, and for the domination of their exports by a handful of primary commodities, such as crude oil, cotton fiber, and metals.[9]

In addition to the adverse impacts on the trade performance of the CARs, trade barriers have other negative effects. In particular, they encourage illegal trade. Faced with high trade taxes or restrictions, traders often resort to illegal ways of conducting trade, such as smuggling

[9] Raballand, Kunth, and Auty (2005) argue that high transport costs play a critical role in causing Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan to generate more trade with other countries of the CIS and less trade with the EU than their relative location would suggest. In addition, high transport costs partly explain why exports of these countries are compressed onto a handful of primary commodities.

Figure 3.4: Cumulative Growth of Merchandise Exports and Imports in Selected Member Countries of the Central Asia Regional Economic Cooperation Program and the World, 2000–2004

(In percent)



Note:
PRC – People's Republic of China

Source: Governments of the Central Asian republics, International Monetary Fund's Direction of Trade Statistics, and the authors' estimates.

and under-invoicing.[10] As a result, a substantial proportion of trade in the region goes unrecorded and the governments lose a considerable part of the proceeds from taxes on international trade. It is estimated that unrecorded imports of consumer goods from the PRC and Turkey to the Kyrgyz Republic exceeded US$94 million in 2002 and unrecorded imports of gasoline and diesel fuel from neighboring countries were almost US$31 million. Unrecorded exports of the small-scale sewing industry were estimated at about US$45 million and the value of reexported consumer goods (including the shuttle traders' margins) at around US$70 million. The total value of these unrecorded imports and exports was about US$240 million or around a fifth of the value of recorded trade.

By increasing incentives for smuggling and under-invoicing and creating opportunities for rent-seeking, high-trade taxes and restrictions fuel corruption. Traders sometimes bribe government officials to obtain licenses for lucrative exports and imports. They often bribe border guards and customs officials to turn a blind eye on smuggling or under-invoicing. Not surprisingly, corruption is a particularly serious problem in the CARs when it comes to international trade.

Trade taxes and restrictions lower domestic prices for exportable goods and raise domestic prices for imported goods. This generally worsens social welfare. Notably, import taxes on consumer goods raise the domestic prices for these goods and worsen consumers' welfare. Although they also generate revenue for the government and increase the income of domestic producers, their net effect on social welfare is usually negative. A typical example is the tariffs on colored TVs in Uzbekistan, which raised the domestic price of colored TVs by about 82% and caused a deadweight loss of between US$5.8 million and US$16.6 million in 2004 (see Box 3.1).

[10] There is a large body of theoretical and empirical literature showing that trade taxes and restrictions lead to under-invoicing, smuggling, rent seeking and other forms of directly unproductive profit-seeking activities. See, for example, Anam (1982), Bhagwati (1974), Bhagwati and Hansen (1973), Bhagwati and Srinivasan (1980), Johnson (1974), Krueger (1974), Pitt (1981), and Sheikh (1974).

Box 3.1: Partial Equilibrium Analysis of Welfare Effects of Trade Taxes: The Case of Import Tariffs on Colored TVs in Uzbekistan

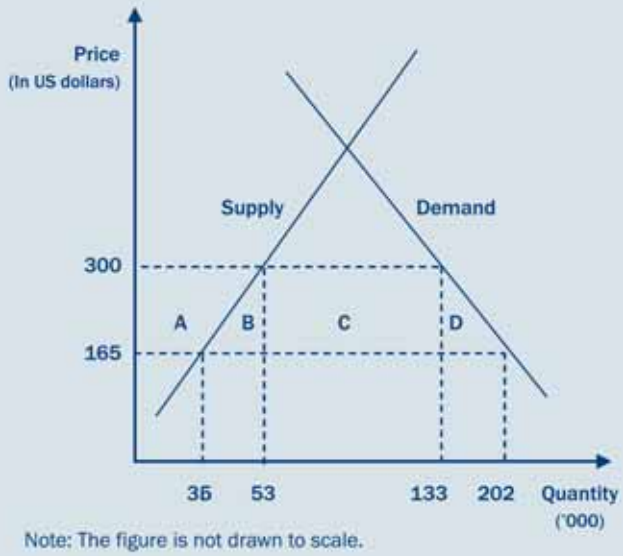
Trade taxes generally have a negative effect on social welfare. A typical example is the tariffs on colored TVs in Uzbekistan.

In 2004, Uzbekistan produced 53,345 units of colored TVs. Additional 70,000 units were imported legally and an estimated 10,000 units imported illegally. Thus, the domestic consumption was 133,345 units. It is estimated that the average domestic retail price was US$300 per unit. The explicit tariff on imported colored TVs was 30% and the implicit tariff—that is, the difference between the rate of the excise tax on imported and domestically produced colored TVs—was 40%. Hence, the average domestic price would have been about US$165 per unit in the absence of the tariffs. Assuming (conservatively) that the price elasticity of demand for a colored TV is -0.5 and that of supply is 0.5, the tariffs reduced the domestic consumption of colored TVs by 68,450 units and increased their domestic production by more than 18,100 units (see Figure B3.1).[11] As a result, domestic consumers lost US$22.6 million (sum of areas A, B, C, and D on Figure B3.1), while domestic producers gained US$6.0 million (area A on Figure B3.1). A total of US$10.8 million (area C on Figure B3.1) went to the government (in the form of tariff revenues), corrupt border guards, customs and tax officials, police officers, etc. (in the form of bribes) and illegal importers (in the form of extra profit), and was at least partly lost due to inefficiencies inherent in smuggling. The net effect of the tariffs on social welfare was somewhere between minus US$5.8 million and minus US$16.6 million depending on how much of US$10.8 million was lost due to inefficiencies in illegal imports of colored TVs. This deadweight welfare loss was larger if the absolute values of the price elasticity of demand for and supply of colored TVs were greater than 0.5.

Accordingly, a reduction in the tariffs on colored TVs would lower their domestic price, increase domestic consumption and imports, and improve social welfare. Policymakers may worry that it would also reduce government revenue and cause a decline in domestic production, which would increase unemployment. In addition, the increase in imports of colored TVs may lead to exchange rate depreciation. These are valid concerns. However, international evidence suggests that indirect effects of reducing tariffs are on balance positive rather than negative. Apart from direct gains in consumers' welfare, reducing tariffs increase the variety of goods and enhance competition in domestic markets. This in turn stimulates domestic producers to improve their own efficiency. As for the loss of government revenue, taxes on income or general consumption are less distortionary than taxes which discriminate against imports.

Source: Authors

Figure B3.1 Market for Colored TVs in Uzbekistan



Note: The figure is not drawn to scale.

By lowering domestic prices for exportable goods and raising domestic prices for imported goods, trade barriers distort domestic relative prices vis-à-vis international relative prices. A good measure of domestic relative price distortions resulting from taxes on international trade are levels of and the variation in effective rates of protection (ERP).[12] Table 3.3 presents the estimated ERPs for selected products in Kazakhstan,

[11] Although demand for colored TVs is considered to be relatively price inelastic in high-income countries (with -0.5 being a typical estimate), it is likely to be more price elastic in middle-income countries, like Uzbekistan. Similarly, domestic supply of colored TVs is likely to be more price elastic than 0.5.

[12] The effective rates of protection for a particular product is the difference between value added (per unit of the product) at domestic prices and value added at international prices expressed as a percentage of the latter.

Table 3.3: Tariffs and Estimated Effective Rates of Protection for Selected Products in Kazakhstan, Kyrgyz Republic, and Uzbekistan, 2005

	Tariff Rate	Effective Rate of Protection
Kazakhstan		
Packed juice	15	46
Sausage	35	44
Dairy products	15	15
Waffles	15	14
Kyrgyz Republic		
Towel	10	33
Butter	10	18
Cotton yarn	0	(3)
Ice cream	0	(11)
Uzbekistan		
Cigarettes	30[a]	124
Daewoo Nexia	30[a]	103
Chocolate	30	77
Men's suit	30	36

Note:
[a] The ad valorem component of the combined tariff.

Source: Authors' estimates. The estimates for the Kyrgyz Republic are partly based on World Bank (2005c).

Kyrgyz Republic, and Uzbekistan. It indicates that there are considerable variations in the ERPs and thus price distortions in all three countries. Moreover, both levels of and the variation in the ERPs in Uzbekistan are much larger than those in Kazakhstan and the Kyrgyz Republic, suggesting that price distortions in the former are more severe than in the latter.

Price distortions resulting from trade barriers in turn have many negative consequences. First, they often afford import-competing products a much higher degree of effective protection than the corresponding tariffs suggest. As shown in Table 3.3, the estimated ERPs for cigarettes and a Daewoo Nexia car in Uzbekistan are more than three times as high as the ad valorem components of the combined tariffs on these products. Second, relative prices distorted in favor of import-competing sectors shift resources from export-oriented to import-competing sectors and redistribute income from the general public and export-oriented sectors to import-competing sectors. Since agriculture is a major export-oriented sector in all the CARs, the majority of the poor live in rural areas, and import-competing sectors are mostly located in urban areas, the price distortions effectively redistribute income from rural to urban population and from the poor to the rich. Third, distorted relative prices result in sub-optimal allocation of resources and inefficient utilization of scarce factors of production. Fourth, price distortions may 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.[13] In the case of severe price distortions, highly protected import-competing sectors may produce positive value added at domestic prices but negative value added at international prices.[14] Growth generated by these sectors would be spurious and reduce social welfare.

[13] See Johnson (1967) for a discussion of the possibility of aggregate income losses from output growth in protected import-competing sectors.

[14] See McKinnon (1993) for an exposition of how a firm producing positive value added at distorted domestic prices may actually be producing negative value added at international prices.

Restrictions imposed by Uzbekistan on cross-border movements of people and transport equipment in an effort to restrict imports from neighboring countries obstruct movements of people for purposes not relating to trade, often forcing them to use more costly alternative routes. The Tashkent-Samarkand highway offers a good example. It is one of Uzbekistan's key motor roads used extensively in both domestic and international transportation. It was built during the period of the Soviet Union and passes through Kazakhstan. During the first 11 years after the breakup of the FSU, Uzbek vehicles could, more or less, freely pass through the Kazakh territory along the highway. In 2002, however, Uzbekistan closed the Kazakh section of the road for Uzbek vehicles.[15] As a result, most Uzbek vehicles now have to take a detour around the Kazakh territory, which is 56 km longer than the direct route. Moreover, the bypass is narrower and in worse condition than the Tashkent-Samarkand highway.

According to a study commissioned by ADB, some 15,500 vehicles took the detour daily in December 2004. With the detour, the vehicles spent 1.0–1.5 hours more to get to the destination than if they had been allowed to use the direct route. This is partly due to the stopping of many of the vehicles at numerous stationary and mobile traffic police posts along the bypass. In addition, each vehicle spent 5–23 liters of fuel more than what it would have spent if it had used the direct route. The total cost of extra fuel spent by all vehicles taking the detour was estimated at about 45.6 million soums or US$44,000 a day at December 2004 prices. This means that the closure of transit through Kazakhstan costs Uzbek drivers and transport operators around 17 billion soums or US$16 million a year in terms of extra fuel needed to get from Tashkent to Samarkand or vice versa.

The barriers to trade in Central Asia created by countries outside the region also entails high costs for the CARs. Most notably, farm subsidies in developed countries cause an oversupply of agricultural products in these countries, which are then dumped in the world markets. This lowers world prices for agricultural products and adversely affects exports of these products from the CARs. It is estimated that without cotton subsidies in the EU and the US, world cotton prices would have been 71% higher. With higher world cotton prices, the gain in export revenue would have added 6% to Tajikistan's GDP and 3% to Uzbekistan's GDP. These substantial benefits would accrue every year after abolition of the subsidies. Moreover, with more attractive world prices, the quantity of cotton exported would increase (by an estimated 5.8% in Uzbekistan), adding to the potential benefits.[16]

3.4 Conclusions

There are significant barriers to trade in Central Asia pertaining to trade policy, transport, and transit systems in the CARs, their neighbors, and trading partners. The more significant trade barriers pertaining to trade policy in the CARs include a complex tariff schedule and relatively high tariffs (Kazakhstan and Uzbekistan); escalation of tariffs (all the CARs); frequent and unpredictable changes in the tariff schedule (Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan); high implicit tariffs in the form of taxes that are levied on imported goods but not on domestically produced goods or have higher rates for imported goods than for domestically produced goods (Azerbaijan, Kazakhstan, and Uzbekistan); explicit export taxes (Azerbaijan and Kazakhstan); and prohibition and licensing of exports and imports of certain commodities (all the CARs). Uzbekistan appears to continue using

[15] The restriction does not apply to trucks transporting goods under a Transport International Routier (TIR) Carnet and vehicles with foreign and diplomatic license plates.

[16] The estimated subsidies, their impact on world prices and Uzbekistan's supply response are from Baffes (2004). The increases in GDP for Uzbekistan and Tajikistan even without any change in output are based on export volumes and GDP in 2000, reported in Pomfret (2005).

restrictions on access to foreign exchange in regulating imports and imposes relatively tight restrictions on cross-border movements of people and transport equipment in an apparent effort to restrict imports from neighboring countries. Large agricultural subsidies that developed countries provide to their farmers also constitute a significant barrier to trade in Central Asia.

Other significant barriers to trade in Central Asia are high transport costs and long and unpredictable transport times for international shipments to and from the CARs. This is not only because of the landlocked and remote location of the CARs and their difficult topography, but also due to deficiencies of their transport networks, high costs and low quality of transport and logistics services in the region, and difficulties with movements of goods and transport equipment across borders and through the territories of the CARs and neighboring countries.

The costs of these trade barriers for the CARs are quite high. They have constrained growth of trade in Central Asia and deprived the CARs of the benefits of forgone trade. They have also limited the participation of the CARs in GPNs and related trade in manufactured products, skewed the structure of their exports towards primary commodities, and hindered the reorientation of their trade from FSU countries to the rest of the world. In addition, trade barriers have encouraged illegal trade, fueled corruption, caused deadweight welfare losses, and distorted domestic relative prices. Distorted relative prices in turn have provided a high degree of effective protection to import-competing sectors and may have generated welfare-reducing and spurious economic growth. They have also shifted resources from export-oriented to import-competing sectors and redistributed income from the general public and export-oriented sectors to import-competing sectors and from the poor to the rich. The restrictions on border crossing imposed by Uzbekistan—in an effort to restrict imports from neighboring countries—have obstructed the movements of people and transport equipment for purposes not relating to trade. This has resulted in considerable losses for drivers and transport operators.

Improved regional cooperation in trade policy, transport, and customs transit could help the CARs lower the trade barriers, expand trade, increase the gains from participation in international trade and reduce the associated risks. Specifically, regional cooperation in trade policy could help the CARs reduce trade barriers pertaining to trade policy in the CARs and their trading partners at relatively low costs, and expand trade considerably. It could also help the CARs reduce the risk of protectionist measures by trading partners. Regional cooperation in transport and customs transit would help the CARs reduce transport costs and transit times for international shipments and make transit times for such shipments more predictable. This would in turn help them boost trade, especially with more distant countries, take more active part in GPNs and related international trade in manufacture products, and diversify trade both in terms of geographical distribution and commodity composition.