# 1
# Introduction

## 1.1 Benefits of International Trade

International trade generally improves social welfare and stimulates economic growth.[1] Trade enables countries to specialize in line with their comparative advantages and achieve economies of scale that would not be possible without specialization. This improves the allocation of resources and social welfare in the short to medium term. Trade also improves social welfare in the short to medium term by increasing the variety and improving the quality of goods available to consumers. In the medium to long term, trade leads to higher rates of economic growth and sustained improvements in social welfare by enhancing competition, disciplining policy makers, and increasing investment in both physical and human capital. In developing countries, trade fosters economic growth and improves social welfare also by helping them attract foreign direct investment (FDI) and acquire modern technologies available in developed countries through imports, FDI inflows, and participation in global production networks (GPNs).[2] Economic growth and improvements in social welfare in turn reduce poverty inasmuch as they raise income and improve the welfare of the poor and increase resources available for social security, primary health care, education, water supply, and other basic services. Accordingly, openness to international trade is widely regarded as a necessary, albeit not sufficient, condition for any country—particularly a small one—to achieve sustainable economic development.

There are, however, three caveats to this general rule. First, participation in international trade has certain costs. Most notably, it makes a country vulnerable to fluctuations in world prices and possible protectionist measures by trading partners. This vulnerability is

[1] Theoretically, the impact of trade on social welfare is always positive in the absence of market failures and policy-induced distortions, but may or may not be negative in the presence of market failures or policy-induced distortions (see, for example, Bhagwati, Panagariya, and Srinivasan [1998]). Likewise, there are theoretical models in which the impact of trade on economic growth is positive and models in which it is negative. Empirically, a large body of evidence suggests that trade stimulates economic growth, although there are several conceptual and technical difficulties in establishing a link between trade and growth. See Berg and Kruger (2003) and Winters (2004) for a survey of the recent empirical literature on the relationship between trade and economic growth.

[2] Participation in global production networks (GPNs) requires participation in international trade. It also increases the gains from trade for developing countries by enabling them to specialize in the labor-intensive stages of manufacturing processes (which, overall, might be technology or capital intensive) and helping them gain better access to markets in developed countries, attract foreign direct investment (FDI), acquire modern technologies, boost manufactured exports, and climb the value-added ladder. At the same time, participation in GPNs poses certain risks for developing countries. See ADB (2003) and Memedovic (2004) for a more detailed discussion of opportunities and challenges GPNs represent for developing countries.

particularly high when a country's exports and/or imports are dominated by primary commodities, the prices of which tend to be more volatile than those for manufactured products, and when its trade is concentrated in a small number of large trading partners, for which trade with the country concerned is relatively insignificant.

Second, in the presence of market failures and policy-induced distortions, trade may have an adverse impact on social welfare and economic growth. For example, trade between two countries generated by imposing artificial specialization on them with little regard for their comparative advantages—as was the case with inter-republican trade in the former Soviet Union (FSU)—can worsen social welfare and hinder economic growth in both countries. Exports of products that are kept competitive in international markets through neglect of negative effects of their production on environment, use of forced cheap labor or mandatory procurement at low domestic prices—as is the case with cotton in some FSU countries—are likely to have a negative impact on social welfare in the exporting country. Similarly, an increase in the volume of exports through a reduction in the export price may result in "immiserizing growth," that is, output growth accompanied by a worsening of social welfare.[3] If there is a so-called "infant" industry—i.e., an industry that is not competitive at present but will become such if protected from foreign competition for a certain period—temporary protection of this industry from foreign competition may improve social welfare compared with free trade.[4]

Third, to be able to participate in and benefit from international trade, a country must have policies, institutions, and infrastructure that support and promote trade. These include liberal trade policy, sound macroeconomic and competition policies, favorable foreign exchange and tax regimes, rule of law, well-functioning financial and marketing institutions, good transport and communication infrastructure, efficient transport and logistics services, and customs administration and border management that facilitate, rather than obstruct, trade.[5] Adopting some of the trade-conducive policies is, however, not costless; building trade-supporting institutions is a relatively long process; and developing good infrastructure requires substantial financial resources. Notably, liberalizing trade policy leads to painful reallocation of resources with output declines, lower wages, and layoffs in previously protected import-competing sectors. This may increase poverty in the short term, depending on which sectors the poor are mostly employed in, how these sectors are affected by trade liberalization and several other factors.[6] In addition, trade liberalization usually increases imports more than exports in the short term. This creates/increases the trade deficit and often necessitates a depreciation of the real exchange rate with negative consequences for inflation, macroeconomic stability, output growth, and poverty.[7]

[3] Bhagwati (1968).

[4] It is worth noting, however, that protecting an "infant" industry from foreign competition improves social welfare compared with free trade only under certain circumstances. And even when it does so, it is a second-best policy intervention compared with targeted subsidization aimed at enhancing the competitiveness of the "infant" industry. Furthermore, for "infant" industry protection to improve social welfare compared with free trade, it must be set at the correct level for the correct period and applied only to those industries that need temporary protection to become competitive. This is almost impossible to do in practice, which largely explains the failure of import-substitution strategies in many countries. Baldwin (1969) shows that trade policy is not an appropriate tool to support an "infant" industry. Bhagwati (1978) and Krueger (1978, 1995, and 1997), among others, discuss reasons for the failure of import substitution strategies.

[5] See World Trade Organization (WTO) (2004) for a discussion of the relationship between international trade, on the one hand, and macroeconomic policies, infrastructure, market structure, and institutions, on the other; and World Bank (2006a) for an analysis of the effects of the trade regime, trade facilitation infrastructure and institutions, domestic competition, and governance in the group of 27 countries of Eastern Europe and the former Soviet Union on their recent trade performance.

[6] See Winters, McCulloch, and McKay (2004) for a discussion of channels through which trade liberalization affects the poor and for a survey of evidence on the impact of trade liberalization on poverty.

[7] Using panel data and times series/cross section analysis for a sample of 22 developing countries, Santos-Paulino and Thirlwall (2004) find that trade liberalization stimulates export growth but raises import growth more, leading to a worsening of the balance of trade and the balance of payments.

## 1.2 Role of Regional Cooperation in Trade Policy, Transport, and Customs Transit in Increasing Gains from Trade[8]

Regional economic cooperation can help countries adopt policies, build institutions, and develop infrastructure they need to expand trade. It can also help increase the gains from participation in international trade and reduce the associated costs. In particular, regional cooperation in trade policy in the form of reciprocal preferential trade liberalization under a regional trade agreement (RTA) can help the participating countries liberalize trade policy at relatively low costs, reduce the risk of possible protectionist measures by trading partners, boost intra-regional trade, and overcome domestic political resistance to broader trade liberalization. Insofar as it leads to broad-based trade liberalization in individual countries, an RTA contributes to multilateral trade liberalization and complements the multilateral trading system that the World Trade Organization (WTO) represents.

However, an RTA not only creates trade between member countries but also diverts trade between member and nonmember countries. Consequently, its net effect on social welfare in member countries and the world as a whole is theoretically ambiguous. Moreover, an RTA can give rise to vested interests in partial trade liberalization, which will oppose broader trade liberalization and make it politically more difficult to carry out. Because of its discriminatory nature, an RTA can also weaken the multilateral trading system, which is based on the principle of nondiscrimination. Whether a particular RTA improves or worsens social welfare, facilitates or hinders broad-based trade liberalization, and complements or weakens the multilateral trading system depends on a number of factors, including the design of the RTA and the context in which it is implemented (see Box 1.1).

Yet, regional cooperation in trade policy need not involve an RTA. Instead, it can focus on a policy dialogue aimed at promoting nondiscriminatory unilateral trade liberalization—as has been the case with the Asia-Pacific Economic Cooperation (APEC)—or coordination of positions in multilateral trade negotiations—as is being done by the group of 20 developing countries (referred to as G-20) in the ongoing Doha Round of multilateral trade negotiations under the auspices of the WTO. Such forms of regional cooperation in trade policy can help reduce policy-induced trade barriers and distortions not only in the participating countries but also in their nonparticipating trading partners.

Other important areas in which regional economic cooperation can help countries expand trade, increase the gains from participation in trade and reduce the associated costs are transport and customs transit. Regional cooperation in these areas in the form of coordinated development and closer integration of national transport networks with each other and with international networks, reciprocal liberalization of trade in transport services, harmonization of transport regulations, facilitation of customs transit, etc. can substantially reduce transport costs, make transit times shorter and more predictable and boost not only intra-regional, but also inter-

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8 Here and in the rest of the report, the term “regional cooperation” refers to coordinated or joint actions by a group of countries, which are not necessarily located in the same geographical region. “Trade policy” refers to taxes as well as quantitative and administrative restrictions directly aimed at affecting levels, commodity composition, and/or geographical distribution of trade. These include tariffs and other taxes on imports, export taxes and subsidies, quantitative restrictions on imports and exports, restrictions on access to foreign exchange for imports, and antidumping measures. Taxes and restrictions (such as taxes on domestic consumption that are equally levied on both imported and domestically produced goods and restrictions on domestic distribution of exportable and imported goods) the primary objective of which is not to affect trade are not considered as instruments of trade policy though they may affect trade. “Transport” refers to transport infrastructure and services as well as legal and regulatory framework for the transport sector. “Customs transit” refers to transportation of goods without paying duties and taxes due on domestic consumption. A distinction is made between external and internal customs transit. “External customs transit” refers to transportation of goods through a transit country. “Internal customs transit” refers to transportation of goods from the point of customs clearance to the point of border crossing in the exporting country or from the point of border crossing to the point of customs clearance in the importing country. A set of rules and procedures under which customs transit is carried out is referred to as a “transit system.”

**Box 1.1: Regional Trade Agreements**

A regional trade agreement (RTA) is an agreement among several countries (not necessarily belonging to the same geographical region), whereby they give each other trade preferences on a reciprocal basis. An RTA can be bilateral (involving two countries) or multilateral (involving more than two countries). Regional integration arrangements involving an RTA are commonly divided into the following five basic categories according to the degree of integration they provide:

1. A Preferential Trade Agreement (PTA), whereby the member countries lower, but not fully eliminate, policy barriers to trade with other member countries;
2. A Free Trade Area (FTA), in which member countries fully eliminate policy barriers to trade with other member countries, but are free to maintain different policy barriers to trade with nonmember countries;
3. A Customs Union, in which member countries fully eliminate policy barriers to trade with other member countries and adopt common tariffs on imports from nonmember countries;[9]
4. A Common Market, in which member countries set up a customs union and remove policy barriers to movements of factors of production, including labor and capital; and
5. An Economic Union, in which member countries set up a common market, adopt a single currency, and conduct common macroeconomic policies.

The greater the degree of integration an RTA provides, the more difficult it is to negotiate. In particular, custom unions are more difficult to negotiate than PTAs and FTAs because a customs union requires agreements on common external tariffs and on how tariff revenue is to be divided among the members. PTAs and FTAs do not require such agreements, but must be supported by rules of origin to prevent deflection of trade, i.e., the routing of imports from a nonmember country to a member country through another member country, which has lower tariffs on imports from the nonmember country.

Three important issues concerning an RTA are:

(i) whether it improves or worsens social welfare in the member countries and the world as a whole;
(ii) whether it facilitates or hinders broad-based trade liberalization in the member countries; and
(iii) whether it is a “building block” or a “stumbling block” of the multilateral trading system.[10]

As first pointed out by Viner (1950) in the case of a custom union, the net effect on an RTA on social welfare in the member countries and the world at large is theoretically ambiguous. On the one hand, an RTA creates trade between member countries by displacing relatively inefficient production in one member country by more efficient imports from another member country. This improves social welfare in both member countries and has no impact on social welfare in nonmember countries. On the other hand, an RTA is likely to divert trade between member and nonmember countries by displacing relatively efficient imports from a nonmember country by less efficient imports from a member country. This worsens social welfare in the importing member country and the nonmember country imports from which are displaced. Therefore, with competitive markets and other things being equal, preferential trade liberalization under an RTA is inferior to nondiscriminatory broad-based trade liberalization, at least as far is its effect on social welfare is concerned.

The net effect of an RTA on the political feasibility of broad-based trade liberalization in the member countries is also theoretically ambiguous. On the one hand, an RTA can help a member country liberalize trade policy at relatively low costs and overcome domestic political resistance to broad-based trade liberalization by gaining better access to markets in the other member countries (in return for giving them better access to its markets) and liberalizing trade policy gradually. On the other hand, an RTA can give rise to vested interests in partial trade liberalization that will oppose broad-based trade liberalization and make it politically more difficult to carry out.

Despite their discriminatory nature, RTAs are legal under the World Trade Organization (WTO) rules. Article XXIV of the General Agreement on Tariffs and Trade (GATT) permits free trade areas and customs unions in merchandise trade. Article V of the General Agreement on Trade in Services permits RTAs in services. The 1979 Decision on Differential and More Favorable Treatment, Reciprocity, and Fuller Participation of Developing Countries (“Enabling Clause”) allows for the special treatment of

[9] In practice, countries rarely fully eliminate policy barriers to trade even within free trade areas and Customs Unions. They usually maintain policy barriers to trade in certain products.

[10] The terms “building blocks” and “stumbling blocks” are due to Bhagwati (1991).

developing countries. RTAs are, however, contrary to the principle of nondiscrimination, which is fundamental to the multilateral trading system that the WTO represents. The principle requires that countries do not discriminate between their trading partners.

The ambiguity of the net effect of an RTA on social welfare and the political feasibility of broad-based trade liberalization in the member countries and the contradiction between the discriminatory nature of an RTA and the principle of nondiscrimination on which the multilateral trading system is based, have led to a big debate in economics literature. Proponents of RTAs argue that RTAs generally improve social welfare, facilitate broad-based trade liberalization, and complement the multilateral trading system.[11] Opponents of RTAs argue that RTAs generally worsen social welfare, hinder broad-based trade liberalization, and undermine the multilateral trading system.[12]

International experience with RTAs suggests that a particular RTA is more likely to improve (rather than worsen) social welfare, facilitate (rather than hinder) broad-based trade liberalization, and complement (rather than weaken) the multilateral trading system under the following conditions:

- The member countries are not involved in many, possibly, overlapping and inconsistent RTAs;
- The RTA has a broad product coverage, and is effectively implemented and open to new members;
- Preferential trade liberalization under the RTA is undertaken in conjunction with comprehensive structural reforms aimed at promoting trade and enhancing the competitiveness of the economy, and is accompanied by broad-based trade liberalization resulting in fairly low nonpreferential policy barriers to trade;
- The rules of origin are nonrestrictive if the RTA is a PTA or an FTA and, especially, if member countries are involved in several such RTAs; and
- Preferential trade liberalization under the RTA is part of efforts by the member countries to lower not only policy-related but also institutional, technical, and other barriers to intra-regional trade and achieve deep regional economic integration.

Sources: Devlin and Giordano (2004), Pal (2004), Schiff and Winters (2003), World Bank (2005a), and the authors.

regional trade.[13] In doing so, regional cooperation in transport and customs transit can help the participating countries diversify their trade in terms of geographical distribution. It can also help the countries attract FDI, increase their participation in GPNs and related trade in manufactured products, and diversify their exports in terms of commodity composition.

Regional cooperation in transport and customs transit aimed at reducing trade costs is particularly important for landlocked countries. This is because landlocked countries heavily rely on transportation by land through the territories of neighboring countries for international trade.[14] Poor transport infrastructure and restrictive transport and customs transit regulations in neighboring countries can increase transport costs considerably and make transit times long and unpredictable for landlocked countries. Goods can lose a substantial proportion of their value during transportation if transit times are long.[15] This is especially true of perishable goods (such

[11] See, for example, Ethier (1998), Krugman (1991), and Summers (1991).

[12] See, for example, Bhagwati (1995), Bhagwati and Panagariya (1996), Krishna (1998), Krueger (1993), Levy (1997), and Panagariya (1996).

[13] Nordas and Piermartini (2004) conclude that the quality of infrastructure in two countries has a significant and relatively large impact on their bilateral trade. Wilson, Mann, and Otsuki (2003) find that raising the quality of seaport and airport infrastructure and improving the customs environment in the below-average Asia-Pacific Economic Cooperation (APEC) member countries to the APEC average would increase intra-APEC trade by about US$128 billion or 11.5%. World Bank (2006a) estimates that if the group of 16 countries of Eastern Europe and the FSU improve their customs regimes and port efficiency halfway to the average of the EU-15 (i.e., the 15 countries that comprised the European Union until its expansion in 2004), their trade with each other would increase by almost US$45 billion and trade with the rest of the world would expand by about US$81 billion.

[14] See Faye et.al (2004) and United Nations Economic and Social Commission for Asia and the Pacific (UN ESCAP) (2003) for a discussion of difficulties that landlocked countries face in accessing world markets and integrating into the global economy.

[15] Hummels (2001) finds that each day in travel is worth an average of 0.8% of the value of a product for United States (US) trade in manufactured products.

as fresh fruits and vegetables) or those subject to frequent changes in consumer preferences (such as high fashion apparel). Unpredictable transit times necessitate larger precautionary inventory holdings and thus increase costs of production.[16] Consequently, unpredictable transit times preclude "just-in-time" business practices, which reduce costs of production by minimizing inventory holdings and require timely delivery.

High transport costs and long and unpredictable transit times undermine competitiveness of exports of landlocked countries in world markets, make their imports more expensive and limit their participation in international trade. Landlocked countries find it particularly difficult to export time-sensitive products, such as perishable goods, to compete with coastal countries in manufactured export activities, where imported inputs account for a large proportion of the value of output and profit margins are small, and to participate in GPNs, which often employ "just-in-time" business practices.[17] In turn, small volumes of trade make it more difficult for landlocked countries to exploit economies of scale in transport and reduce transport costs. Many developing landlocked countries are, therefore, trapped in the vicious cycle of small trade volumes keeping transport costs high and high transport costs constraining trade, economic growth, and development.[18] Regional cooperation in transport and customs transit can help landlocked countries break this vicious cycle and overcome the disadvantage of their location.[19]

Moreover, liberalization of trade policy and regional cooperation in transport and customs transit are closely interlinked for landlocked countries. Progress in any of these areas will have a limited positive impact on trade if there is no progress in the others. For example, reciprocal trade liberalization by a landlocked country and its nonadjacent trading partner will not boost their bilateral trade much if movements of transport equipment and goods through connecting countries remain difficult or impossible due to deficiencies of transport infrastructure or restrictive transit systems in those countries. Likewise, improvements in transport infrastructure and transit systems in neighboring countries will do little to integrate a landlocked country into the international trading system if its trade policy remains restrictive. If combined, however, regional cooperation in trade policy, transport, and customs transit can make a major contribution to the expansion of trade and economic development in landlocked countries (see Figure 1.1).

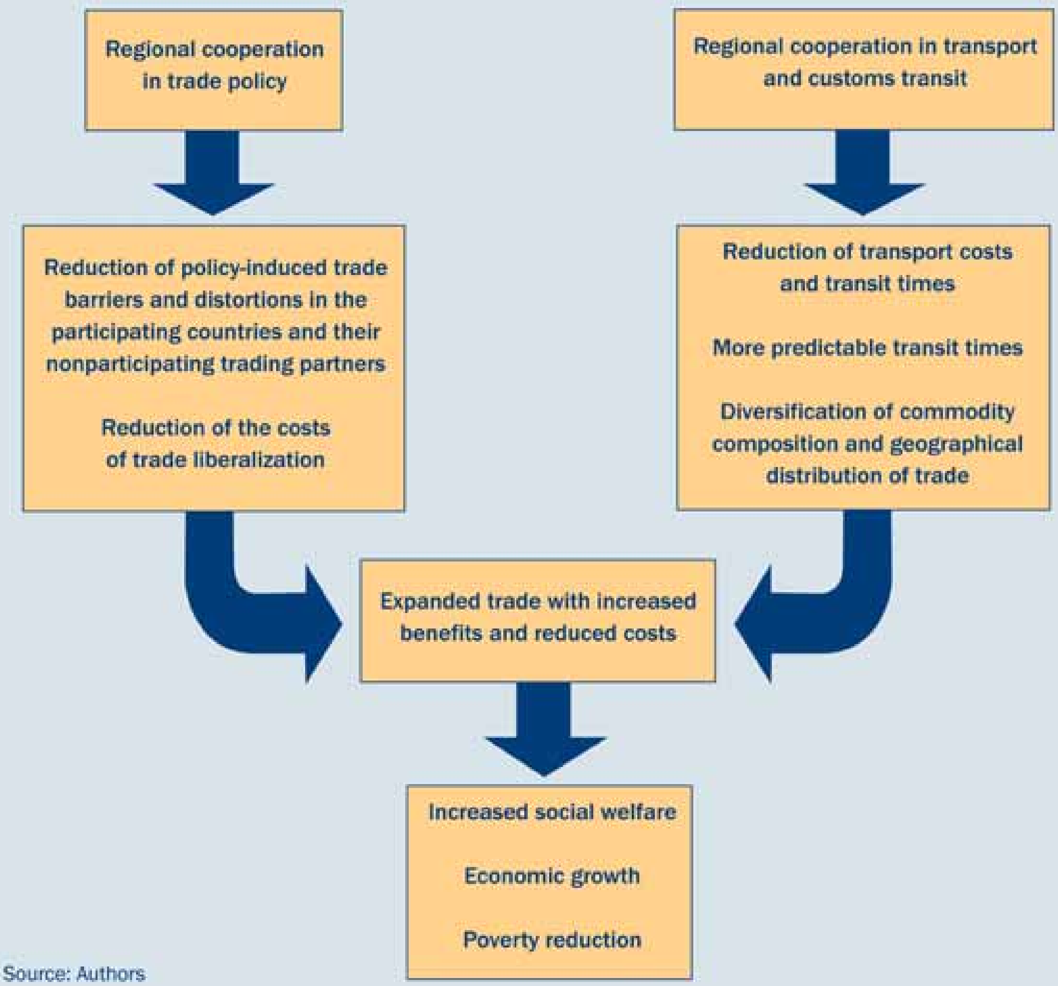
[16] Gaush and Kogan (2001) find that inventory holdings in the manufacturing sector in developing countries are two to five times higher than in the US, and estimate that cutting inventory levels in half would reduce the unit cost of production by over 20%.

[17] Djankov, Freund, and Pham (2006) find that, on average, each additional day spent on moving containerized products from a factory gate to a ship reduces trade by at least 1%. Delays have an even greater impact on exports by developing countries and exports of time-sensitive goods, such as perishable agricultural products. In particular, a one-day delay reduces a country's relative exports of time-sensitive to time-insensitive agricultural products by 7%. Hummels (2001) estimates that each additional day in ocean transit reduces the probability that a country will export to the US by 1.0% for all products and 1.5% for manufactured products. Limao and Venables (2001) find that a representative landlocked country has transport costs 46–55% higher and trade volumes about 60% lower than a representative coastal country.

[18] Radelet and Sachs (1998) find a strong relationship between shipping costs and economic growth. Their results imply that doubling shipping costs is associated with slower annual growth of more than 0.5%. Other things being equal, a landlocked country with shipping costs 50% higher than a similar coastal country grows at a rate 0.3% lower than the coastal country. Overman, Redding, and Venables (2001) find that access to foreign markets [which landlocked countries have difficulties with] explains some 35% percent of cross-country variation in per capita income. United Nations Development Programme (UNDP) (2004) classifies 12 out of 30 developing landlocked countries as "low human development," with 9 of the 14 countries with the lowest human development index being landlocked.

[19] Limao and Venables (2001) estimate that, if a representative landlocked country and its neighbors all improve their infrastructure—as measured by the lengths of roads, paved roads and rail per square kilometer of the country area, and the length of telephone lines per person—from the median level to the level of the 75% percentile in the corresponding group, the transport cost penalty for the landlocked country falls from 46–55% to 31–33%. APEC (2002) finds that customs-related trade facilitation would reduce trade transactions costs by 2.9–7.4% in industrialized APEC economies, 5.3–10.7% in newly industrialized APEC economies, and 6.6–14.8% in industrializing APEC economies.

**Figure 1.1: How Regional Cooperation in Trade Policy, Transport, and Customs Transit Can Contribute to Economic Development in Landlocked Countries**




Source: Authors

## 1.3 Purpose, Scope, Approach, and Structure of the Report

This report seeks to show how Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan—five member countries of the Central Asia Regional Economic Cooperation (CAREC) Program referred to in the report as the Central Asian republics (CARs)—can increase the gains from participation in international trade and reduce the associated costs through regional cooperation in trade policy, transport, and customs transit among themselves and with other countries—in particular, the other CAREC member countries.[20] The CARs are all relatively small economies and need to promote trade and closely integrate into the international trading system to achieve sustainable economic development (see Table 1.1). It is this consideration that partly motivated the CARs to conclude numerous RTAs and seek new

[20] The other member countries of the Central Asia Regional Economic Cooperation (CAREC) Program are Afghanistan, People's Republic of China (PRC), and Mongolia. More information about the CAREC Program can be found at http://www.adb.org/carec/
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**Table 1.1: Population and Gross Domestic Product of the Central Asian Republics, 2005**

| | Population | GDP at Current Prices | GDP at PPP-Based Valuation | Share of World's GDP at PPP-Based Valuation |
|---|---|---|---|---|
| | (In millions) | (In billion US dollars) | (In billion US dollars) | (In percent) |
| Azerbaijan | 8.4 | 12.1 | 37.8 | 0.06 |
| Kazakhstan | 15.0 | 54.0 | 124.0 | 0.21 |
| Kyrgyz Republic | 5.2 | 2.3 | 10.6 | 0.02 |
| Tajikistan | 6.3 | 2.3 | 8.7 | 0.02 |
| Uzbekistan | 26.2 | 11.0 | 48.1 | 0.08 |

Note:
GDP – gross domestic product
PPP – purchasing power parity

Source: International Monetary Fund's World Economic Outlook Database. Available at http://www. imf.org/.

RTAs among themselves and with other countries. As noted above, involvement in RTAs can improve or worsen social welfare in the CARs. Further, it can help the CARs closely integrate into the international trading system or prevent them from doing so. Despite the importance of the issue, few studies analyze the consequences for CARs of involvement in an existing RTA or a proposed new RTA.[21]

Unlike regional cooperation in trade policy, regional cooperation in transport and customs transit is unambiguously beneficial for the CARs. Moreover, it is essential if the CARs are to overcome disadvantages and harness advantages of their location, fully integrate into the international trading system, and achieve sustainable development. On the one hand, the CARs are all landlocked and situated far from seaports and developed countries. This constrains their trade with developed and other distant countries. On the other hand, the CARs are located at the crossroads between East and South Asia and Europe and close to some of the world's largest and fastest growing emerging markets, such as the People's Republic of China (PRC), India, and Russian Federation. Furthermore, the CARs have inherited highly integrated transport networks from the FSU, which crisscross their national borders but are not yet fully integrated into international transport networks. Moreover, Tajikistan, Kyrgyz Republic, and Uzbekistan each have exclaves in the territory of the other two.[22] Movements of people, transport equipment, and goods from the exclaves to the other parts of the country they belong to inevitably involve transit through another country. In varying degrees, the CARs also serve each other as transit countries in international trade.

Regional cooperation in transport and customs transit is needed for the CARs to utilize their existing transport networks effectively and closely integrate them with

21 To our knowledge, the only published study on the subject is Tumbarello (2005), which analyzes how the implementation of the customs union of the Eurasian Economic Community (EAEC) (then consisting of Belarus, Kazakhstan, Kyrgyz Republic, Russian Federation, and Tajikistan) would affect the accession of Belarus, Kazakhstan, Russian Federation, and Tajikistan to the WTO. Using a partial equilibrium analysis, it also estimates the welfare effects of the implementation of the customs union before and after the accession to the WTO.

22 Exclave or enclave is a piece of the territory of one country within the territory of another country. The piece is an exclave for the country to which it belongs and an enclave for the country within which it is located.

international transport networks. Combined with measures to gain better access to their markets, regional cooperation in transport and customs transit would enable the CARs to take advantage of rapid economic growth and concomitant increases in import demand in the neighboring countries and boost exports to those countries. It would also help the CARs expand trade with more distant countries and become, once again, a land-bridge for trade between East and South Asia and Europe, which the region used to be during the period of the Silk Road. Moreover, the Kyrgyz Republic, Tajikistan, and Uzbekistan need to cooperate with each other in transport and customs transit to facilitate movements of people, transport equipment and goods between their exclaves and the other parts of the country.

A number of recent studies have looked into trade barriers pertaining to transport, customs administration and border management in CARs and neighboring countries and their effects on trade in the region. Raballand, Kunth, and Auty (2005) examine the impact of transport costs on trade between Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, on the one hand, and the European Union, on the other. World Bank has commissioned audits of trade and transport facilitation in Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan and prepared a Tajikistan trade diagnostic study and a policy note on trade and transport facilitation in Azerbaijan.[23] World Bank has also prepared a report on trade and transport facilitation in Central Asia, which analyzes land transport, customs operations, and border management in Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan and their impact on trade and transport facilitation in the region.[24] World Bank (2006a) discusses issues in the transport sector and trade facilitation in a group of 27 countries of Eastern Europe and the FSU, including the CARs, and estimates potential gains from the strengthening of capacity for trade facilitation in a subgroup of these countries. These studies, however, do not analyze how regional cooperation can help the CARs reduce trade barriers relating to transport and customs transit—two areas in which regional cooperation is crucial for trade and transport facilitation in the CARs.

This report differs from the other studies on regional economic cooperation in Central Asia and trade and transport facilitation in CARs on two essential aspects. First, it treats regional cooperation in Central Asia in the areas of trade policy, transport, and customs transit in a holistic manner, taking into account the importance of and the synergy between regional cooperation in these areas for the CARs.[25] Second, the report attempts to quantify the costs of the lack of cooperation and the potential benefits of improved regional cooperation in the three areas for the CARs. At the same time, the report builds on and, to some extent, synthesizes earlier studies on this and related topics conducted or commissioned by the Asian Development Bank (ADB) as part of its efforts to promote regional economic cooperation in Central Asia.

Some of the findings of the ADB study on Central Asia regional cooperation in trade, transport, and transit presented in this report are also presented in the United Nations Development Programme (UNDP) (2005). The report, therefore, overlaps with UNDP (2005) to a certain extent. At the same time, it adds depth, detail, and new data to UNDP (2005) with respect to regional cooperation in trade policy, transport, and customs transit. In particular, it provides a more in-depth analysis of the recent merchandise trade performance of the CARs and presents more rigorous estimates of the effects of regional cooperation in these areas on the Kyrgyz Republic. Like UNDP (2005), the report is intended to inform policymakers in

23 NEA Transport Research and Training (2003a, 2003b, 2003c, and 2003d) and World Bank (2003 and 2006b).
24 World Bank (2005b).
25 The report does not, however, discuss other areas of policy management, institutional building, and infrastructure development (such as macroeconomic management, financial sector reform, and development of communication infrastructure) that are also essential for promoting trade in Central Asia and where there is room and need for regional economic cooperation. UNDP (2005) discusses regional cooperation in some of these areas.

the region and contribute to the ongoing dialogue on regional economic cooperation in Central Asia.

The rest of the report is organized as follows. Chapter 2 reviews the recent trade performance of the CARs in terms of levels, commodity composition, and geographical distribution of merchandise exports and imports. Chapter 3 identifies the more important barriers to trade in Central Asia that can potentially be reduced through regional cooperation in trade policy, transport, and customs transit.[26] It also highlights the costs of these trade barriers, including their negative effects on the recent trade performance of the CARs. Chapter 4 reviews RTAs involving CARs and assesses their effects on the CARs. In particular, it presents estimates of the effects of implementing the customs union of the Eurasian Economic Community (EAEC) on Kazakhstan, based on Kazakhstan's computable general equilibrium (CGE) model. The chapter then reviews the status of the CARs' accession to the WTO and discusses the benefits and costs of WTO membership for the CARs and options for regional cooperation in trade policy that the CARs can pursue within the multilateral framework. Chapter 5 reviews the transport sector in Central Asia, identifies inadequacies of transport infrastructure, the legal and regulatory framework for the transport sector, and transport and logistics services in the CARs. It then discusses the benefits of regional cooperation in transport for the CARs and reviews recent initiatives in this area. Chapter 6 reviews the road transit systems in place in the CARs; identifies their inadequacies; and discusses how the CARs can facilitate customs transit through regional cooperation in this area among themselves and with neighboring countries. Chapter 7 presents estimates of the effects of regional cooperation in trade policy, transport, and customs transit on the Kyrgyz Republic, based on its CGE model. Chapter 8 summarizes key messages of the report and presents its recommendations.

[26] Henceforth in the report, Central Asia refers to the region comprised of Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, and Uzbekistan.