

Overall Conclusions and Recommendations

8.1 Overall Conclusions

Since the breakup of the FSU, the CARs have made considerable progress in expanding market-based trade with both FSU and non-FSU countries, and integrating into the global economy. Their merchandise trade grew rapidly in 2000–2004, and they all appear to have fully realized their trade potential in 2004 in terms of the overall level of trade. Nonetheless, the growth of trade in the Kyrgyz Republic, Tajikistan, and Uzbekistan was slower than that in many other countries. Excluding exports of crude oil and oil products and imports of capital goods for oil sector development, the expansion of trade in Azerbaijan and Kazakhstan was also relatively modest.

Moreover, a handful of primary commodities, such as crude oil, metals, and cotton fiber, continued to dominate the CARs' exports. Indeed, the rise in world prices for these commodities was a major factor that contributed to the rapid growth of their exports. At the same time, participation of the CARs in GPNs and related international trade in manufactured products remained very limited. Furthermore, the CARs' exports and, to a lesser extent, imports remained concentrated in a small number of countries. An analysis based on the gravity model suggests that the CARs "overtraded" with most other CIS countries in 2004, but "under-traded" with most East and South Asian and Western European countries as well as the US.

Heavy reliance on exports of a few primary commodities makes the CARs vulnerable to abrupt swings in volatile world prices for these commodities and complicates economic management. Their limited participation in GPNs and related trade in manufactured products means that the CARs derive relatively little benefits from trade in terms of attracting foreign direct investment, gaining access to advanced technologies, and fostering sustained economic development. The concentration of trade in a small number of countries makes the CARs vulnerable to changes in imports demand in, and possible trade sanctions by, those countries.

The presence of numerous trade barriers pertaining to trade policy, transport, and transit systems in the CARs their trading partners, and transit countries have constrained the growth of trade in the CARs. It has also hindered reorientation of their trade from FSU to non-FSU countries, limited their participation in GPNs and related trade in manufactured products, and skewed the structure of their exports towards primary commodities. 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). 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 due to the landlocked and remote location of the CARs and their difficult topography, but also due to the deficiencies of their transport networks, high costs and low quality of transport and logistics services in the region, and difficulties with movements of transport equipment and goods across borders and through the territories of the CARs and neighboring countries.

Although the CARs have considerably improved their transport links with non-FSU countries since independence, the lack of financial resources and poor coordination of national transport infrastructure projects have been hindering the integration of their transport networks into international transport networks. At the same time, the CARs have built a number of new roads and railways primarily to avoid transit through a neighboring country. The CARs now possess extensive transport networks, but many of them are in poor condition and require rehabilitation. Other elements of transport infrastructure—with the exception of the air transport infrastructure in Azerbaijan, Kazakhstan, and Uzbekistan—are also underdeveloped and in poor condition.

The availability, quality, and costs of transport services in the CARs compare unfavorably with many other countries. Lack of competition is one of the main reasons for the low quality and high costs of rail, air, and international road transport services. Competition is stiff in the market for domestic road transport services. The cost of these services is relatively low but the quality is not high. The availability of multimodal transport operations is limited and costs of international transport services for

small cargo are relatively high due largely to the underdevelopment of logistics infrastructure and services.

National transport legislation and regulations in the CARs differ significantly and create serious obstacles to cross-border and transit traffic. A major problem is the availability and the cost of transport permits, which foreign transport operators generally need to obtain for their vehicles to be allowed to enter (and pass through) a CAR territory. There is a shortage of reciprocal (free) transport permits while the cost of nonreciprocal transport permits is high. In addition to obtaining a transport permit, foreign transport operators usually need to pay various taxes and charges, such as a road tax and an excess axle load charge. Also, foreign drivers generally need a visa to enter a CAR and have to obtain it in advance at an embassy of that CAR. This often causes delays because the CARs have cumbersome visa procedures and do not have embassies in many countries.

Certain aspects of the transit systems currently in place in the CARs impose constraints on cross-border movements of goods by rail and by road. These are, however, not crucial for cross-border movements of goods by rail, for which transport-related factors are a binding constraint. By contrast, inadequacies of the road transit systems impose a binding constraint on trade in Central Asia.

The main deficiency of the national road transit systems of the CARs is that they cover only one country and do not provide a “chain guarantee.” Consequently, a transport operator undertaking customs transit under the national transit systems has to submit separate transit documents and provide separate guarantees in the country of origin, the country of destination, and each of the transit countries. Providing a guarantee even in one country can be quite costly, let alone providing a guarantee in several countries. In the absence of a guarantee, convoying is usually required for customs transit under the national transit systems. A major problem with convoying is that the fee for the service is rather high in some of the CARs. Thus, the variable costs of the national transit systems in the CARs are quite high.

The TIR system—that is, the international transit system based on the TIR Convention signed by all the CARs—provides a “chain guarantee” and has proven to be very effective in facilitating customs transit by road, especially when it involves crossing multiple borders. However, the fixed costs of the system (i.e., the cost of transport equipment that meets the requirements of the TIR Convention and the cost of the insurance guarantee that the TIR system provides) are too high for most transport operators from the CARs. Moreover, the benefits of the system are not always realized in the CARs due to border infrastructure problems, noncompliance by customs, and corruption.

Recognizing that their trade performance depends not only on their trade policy, transport sector, and transit systems but also on the trade policy, transport sector, and transit systems of neighboring countries, the CARs have actively pursued regional cooperation in these areas. In particular, they have joined several regional organizations that involve or seek to reach a multilateral RTA. Additionally, they have entered into numerous bilateral RTAs with other CIS countries. Many of these RTAs have not entered into force, while most of those that have formally entered into force have not been implemented. Consequently, their impact on the trade policy regime and the pattern of trade in the CARs has so far been limited. If fully implemented, however, the concluded and planned RTAs involving the CARs may cause considerable trade diversion and have significant adverse effects on the CARs. Notably, implementing the EAEC customs union is likely to slow down economic growth in Kazakhstan, Kyrgyz Republic, and Tajikistan significantly, unless it is accompanied by a substantial reduction in common external tariffs of its member countries.

In contrast, the potential benefits of WTO membership for the CARs are considerable. They have increased significantly with the accession of the PRC in 2001, and will increase further as more of the CARs’ neighbors (including the Russian Federation) join the organization. Acceding to the WTO is, however, not enough for the CARs to realize the benefits of WTO membership. As the experience of the Kyrgyz Republic

shows, good transport links with other WTO member countries and easy transit through neighboring countries are also necessary.

WTO membership also entails costs for the CARs, but these are often exaggerated and misinterpreted. The real costs of WTO membership are those directly associated with the accession process and not those associated with policy reforms that a country often implements in connection with WTO accession. Multilateral and bilateral development agencies can provide technical assistance in building institutions and capacity required for WTO accession.

WTO membership does not preclude regional cooperation in trade policy. In fact, there are several options for such cooperation that the CARs can pursue within the multilateral framework. Of these, concerted but nondiscriminatory trade liberalization and joint efforts with other developing countries to push for the elimination of cotton and other agricultural subsidies in developed countries are of particular importance for the CARs. WTO membership is also consistent with regional cooperation in transport and customs transit.

There have been a number of regional cooperation initiatives aimed at removing the deficiencies of transport infrastructure and services and facilitating cross-border and transit traffic in the CARs and in neighboring countries. Notably, the CAREC member countries have recently agreed on the Regional Transport Sector Road Map, which formulates the strategic priorities for regional cooperation in the transport sector and addresses most of the deficiencies of rail and road transport in Central Asia.

In an effort to establish regional transit systems that could be used for intraregional customs transit by road and would be less costly than the TIR and national road transit systems, the CARs have signed numerous transit agreements with each other as well as with neighboring countries. These agreements have, however, had a very limited effect on customs transit in Central Asia for a variety of reasons. Some of them have not entered into force while those that have entered into force have not been implemented

or have not reduced costs of customs transit significantly due to an inadequate design.

Consequently, the need remains for the CARs and their neighbors to develop an effective and relatively inexpensive regional transit system for short-distance customs transit by road. Given the success of the TIR system, its design could serve as a basis for such a regional transit system. However, the design of the TIR system would have to be modified to make the fixed costs of the regional transit system less expensive than those of the TIR system. Since negotiating multiparty agreements is relatively difficult, several bilateral transit systems could initially be set up as an intermediate step towards the regional transit system.

The TIR system will be indispensable for long-distance customs transit by road that involves crossing multiple borders. The CARs therefore need to ensure full implementation of the TIR Convention on their territories. Although the TIR Convention is a multilateral agreement, the CARs could use regional cooperation mechanisms to put peer pressure on those countries which have signed the Convention but are not fully implementing it.

Quantitative estimates based on the CGE model of the Kyrgyz Republic suggest that the CARs would reap considerable benefits from increased regional cooperation in transport and customs transit. If the estimated reductions in transport costs that would result from increased regional cooperation in these areas occurred in 2006, the cumulative increase in the Kyrgyz Republic's real GDP in 2006–2015 would be US\$2.1 billion (at 2002 prices) greater or 112.3% (relative to 2005) higher than in the baseline scenario. Although similar quantitative estimates for the other CARs are not yet available, one can expect Tajikistan to benefit from increased regional cooperation in transport and customs transit more than the Kyrgyz Republic. The benefits of increased regional cooperation in these areas for Azerbaijan, Kazakhstan, and Uzbekistan would also be significant, albeit somewhat smaller than those for the Kyrgyz Republic and Tajikistan.

This means that deep regional economic integration that involves not only preferential trade liberalization but also increased regional cooperation in transport, customs transit, and other areas of trade facilitation can be beneficial for the CARs. The positive effects of increased regional cooperation in transport and trade facilitation can more than offset the negative effects of preferential trade liberalization. This is more likely to be the case when preferential trade liberalization is accompanied by broad-based trade liberalization resulting in fairly low nonpreferential policy barriers to trade.

8.2 Recommendations

The findings of this report suggest that it will help the CARs increase the gains from participation in international trade and reduce the associated costs if they:

- Intensify efforts to join the WTO and further liberalize trade policy on a nondiscriminatory basis as part of the WTO accession process (in the case of Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan)
- Liberalize trade policy in a more coordinated manner to avoid a situation in which trade liberalization by one country prompts its neighbors with a more restrictive trade policy to tighten restrictions on cross-border movements of people and transport equipment in an effort to counter the deflection of their trade with other countries through the country, liberalizing trade policy more rapidly;
- Join efforts with other developing countries to gain better access to markets in developed countries and push for the elimination of agricultural subsidies in those countries;
- Rationalize the existing RTAs, broaden their product coverage, and simplify the rules of origin (in the case of PTAs and FTAs);

- Develop and carry out—together with other CAREC member countries—a time-bound action plan to implement the Regional Transport Sector Road Map of the CAREC Program;
- Extend, in consultation with other CAREC member countries, the Road Map to address the deficiencies of air transport in Central Asia;
- Remove the infrastructure bottlenecks constraining movements of goods across borders by rail;
- Enhance competition in rail, air, and international road transport—in particular, by restructuring state-owned railways and airlines, separating regulatory and commercial functions in the transport sector, and creating a level playing field for domestic and foreign transport operators;
- Ensure full implementation of the TIR Convention; and
- Develop an effective and relatively inexpensive regional transit system for short-distance customs transit by road.

Regional organizations and programs involving CARs will help the CARs improve regional cooperation in transport and trade facilitation and increase the gains from participation in international trade if they:

- Ensure that the multilateral RTAs have a broad product coverage, simple rules of origin (in the case of PTAs and FTAs) and low external tariffs (in the case of customs unions);
- Ensure that preferential trade liberalization by the member countries under the multilateral RTAs is accompanied by (i) broad-based trade liberalization resulting in fairly low nonpreferential policy barriers to trade and

(ii) increased regional cooperation in transport, customs transit, and other areas of trade facilitation;

- Intensify efforts to promote regional cooperation among the CARs and their neighbors in the areas of transport and trade facilitation;
- Help the CARs better coordinate national road and rail transport infrastructure projects, focusing them on improving the region's transport links with the other parts of the world—in particular, through the TRACECA, Asian Highway and Trans-Asian Railway projects; and
- Set up a mechanism for monitoring the implementation of the TIR Convention in the CARs and their neighbors.

Multilateral and bilateral development agencies will help the CARs closely integrate into the international trading system, increase the gains from trade, and achieve sustainable development if they:

- Help Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan join the WTO as soon as possible by increasing and better coordinating technical assistance for this purpose;
- Integrate technical and financial assistance in the areas of trade policy, transport, and trade facilitation, for example, by tying funding for transport infrastructure projects to requirements aimed at facilitating cross-border movements of goods and transport equipment;
- Increase technical and financial assistance in improving the quality of transport and logistics services in the CARs;
- Provide technical assistance to the CARs and their neighbors in developing—possibly under

the auspices of one of the regional organizations or programs—an effective and relatively inexpensive regional transit system for short-distance customs transit by road; and

- Undertake more analytical work that demonstrates the benefits of improved regional economic cooperation and helps build supportive constituencies.