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SUBREGIONAL TRADE INITIATIVES IN CENTRAL ASIA:

**THE ECONOMIC COOPERATION ORGANIZATION
AND
THE CENTRAL ASIAN ECONOMIC UNION**

by

Richard Pomfret

Professor of Economics
University of Adelaide
Adelaide SA 5005, AUSTRALIA

Subregional Trade Initiatives in Central Asia: ECO and CAEU

Within the Eurasian space, Central Asia has had the most fluidity in terms of international economic relations and subregional initiatives during the 1990s. The five new independent states had no experience of statehood, little national identity, and almost no warning that they would become independent in 1991. The following years were dominated by nation building and institution creation, and in international relations by a search for groupings and allies within and beyond the region.

After initial attempts to cushion themselves from the economic shocks of the dissolution of the USSR by remaining within the ruble zone, the Kyrgyz Republic, Turkmenistan, Kazakstan and Uzbekistan had all embarked on more independent economic policies by the end of 1993. Relations with Russia and other members of the Commonwealth of Independent States remained dominant, but their importance diminished rapidly during the remainder of the 1990s.¹ Despite much talk of intra-CIS regional trade arrangements, only Kazakstan and the Kyrgyz Republic sought to formalize these by joining the Russia-Belarus customs union in March 1996. The Tajikistan regime remains heavily dependent on Russian support, but this is a bilateral arrangement.² Uzbekistan and Turkmenistan have remained outside formal CIS economic arrangements, opposed to the inevitable Russian domination of external commercial policy in any CIS customs union.

Looking beyond the historic Soviet links, the new independent states have also explored possible subregional groupings based on geography, language, culture or other links. The linguistic ties between Turkey and Kazakstan, the Kyrgyz Republic, Turkmenistan and Uzbekistan and between Iran and Tajikistan have led to associations of Turkic and Farsi speaking nations, with little economic content. Associations centred on the Caspian Sea or the Black Sea play a role as fora for discussing maritime issues, but have little broader significance. The two most important types of groupings are a narrower Central Asia association, represented by the Central Asian Economic

Union (CAEU), and a broader grouping of all non-Arab Islamic countries west of India, represented by the Economic Cooperation Organization (ECO).

This paper will analyse the development of ECO and the CAEU, and assess their future prospects. As with other subregional arrangements, the origins and evolution of both organizations have been strongly influenced by politics. Central Asia is riven by competition, especially between Uzbekistan and Kazakhstan for leadership within the region and between Iran, Turkey and Pakistan for influence over their landlocked Central Asian neighbours.³ The political aspects cannot be ignored, but this paper will focus on economic aspects of the subregional groupings, which are critical to their long-term impact.

1. Trade Policy Options for Former Soviet Republics

With the sudden collapse of the Soviet Union in late 1991 and emergence of fifteen new independent states, international trade policy had to be considered in the new capitals. The economic arguments for all of the smaller republics were clear; as small open economies they would benefit most from liberal non-discriminatory trade policies.⁴ The new governments were, however, concerned with the adjustment costs of bringing domestic prices in line with world prices, probably imposing a drastic change in the output mix. One way of reducing the adjustment costs was to sustain old demand and supply links by retaining a common currency and not imposing restrictions on intra-CIS trade.

Discriminatory trade policies encourage trade with a favored partner even when that partner is not the least-cost supplier of a good. In a customs union or free trade area where trade among members is duty-free, if the tariff-inclusive price of imports from the least-cost supplier exceeds the tariff-free price of imports from a fellow member, then consumers will buy the latter good even though the former is cheaper for the nation (the tariff revenue paid by consumers is redistributed to benefit residents). Such trade diversion from the least-cost to a higher-cost producer hurts the importing

country and misallocates global resources, although the favored trading partner benefits.⁵

Free trade areas (FTAs) are easier to negotiate than customs unions (CUs) because each FTA member retains its own external trade policy. In a customs union, the members have to agree on their common commercial policy and on how the tariff revenue will be used. Nevertheless, successful FTAs are uncommon, because of the problem of trade deflection. Importers will bring a good into the FTA through the member country whose external trade barriers are lowest and then move the good across the FTA's internal borders to satisfy import demand in the more highly protected markets. Such trade deflection will be less severe if transport costs are high, but for contiguous FTA members trade deflection is difficult to avoid. Rules of origin may be introduced, requiring documentation of the national origin of goods, but checking origin documents at borders is a serious cost when one goal of FTAs or CUs is to do away with time-consuming paperwork at internal borders. Moreover, rules of origin are ineffective for homogeneous goods as long as they are produced in the less protectionist FTA member; external imports will enter the low-protection member, displacing some domestic output which will be exported, duty-free, to the more protectionist internal markets, and this process will continue until prices are equalized across the FTA. The member country trying to protect domestic producers will be unable to provide such protection, and it will not even receive any customs revenue. The economic pressure is for each member to cut its own tariffs in order to be the entry point at which tariffs are paid. Ultimately, FTAs tend to collapse or be transformed into CUs.

The USSR was a customs union with centrally planned internal and external trade. With the end of central planning and emergence of the new independent Soviet successor states, the customs union was transformed into a free trade area with a mixture of market-determined and regulated prices. This created many new opportunities for profitable internal trade, some desirable and others not. The situation

from the perspective of the five Central Asian countries will be analysed in the next section of this chapter.

The USSR was, of course, not just a customs union, but a complete economic and political union. Customs unions are often formed as part of nation-building (as in Canada in 1867 and Australia in 1901) or as a step towards future political union (as with the German *Zollverein*); the European Union (EU) is the most important current example of politically driven economic integration. The decision by many European countries in transition from central planning to seek EU membership has a political dimension which outweighs perceived economic benefits or costs. Free trade areas have also usually had a political dimension. The European Free Trade Association (EFTA), for example, was a vehicle for European countries unhappy with the supranationality of the EU to form a common negotiating group, which succeeded in obtaining an EFTA-EU FTA in manufactured goods in 1972 while avoiding the need for the EFTAs to comply with the EU's common agricultural policy and common commercial policy; in the long-run, however, EFTA has dwindled in size and significance as members have defected to the EU. Despite the poor long-run economic records of FTAs, politicians view their formation as a low-cost means of signalling political closeness or solidarity, as with NAFTA or Mercosur in the western hemisphere.

The conflict between the political hopes vested in FTAs or CUs and the economic costs of discriminatory trading arrangements underlies the ambiguous approach to such agreements in international trade law. The first article of the General Agreement on Tariffs and Trade (GATT) signed in 1947 and subsumed by the World Trade Organization (WTO) since 1995, contains a strong statement in favor of nondiscrimination, requiring all signatories to treat trade with all other signatories equally by granting them unconditional most-favored nation treatment. Yet in Article XXIV, an exception is made for CUs and FTAs, as long as they cover substantially all trade among the members and do not raise external trade barriers. Article XXIV recognizes that CU or FTA formation cannot be prevented, but tries to limit the

economic costs by outlawing piecemeal designer discrimination, ie. preferential treatment of trading partners is permitted if preferential treatment is total but banned otherwise.

Regional trading arrangements sometimes go beyond CUs or FTAs into deeper economic integration without including political integration. The 1983 Closer Economic Relations agreement between Australia and New Zealand involved, or foreshadowed, a whole series of deeper integration measures, harmonizing regulations in several sectors of the two countries' economies.⁶ Asia-Pacific Economic Cooperation (APEC) is a looser forum aimed at trade facilitation and embodying "open regionalism" in contrast to the exclusive clubs of CUs or FTAs.⁷

Especially within Asia there has also been a phenomenon of subregional economic zones (SRZs) crossing national frontiers and involving only part of national economies.⁸ The best-known SRZ is the Singapore-Johor-Riau (Sijori) zone which includes parts of Malaysia and Indonesia. A similar growth triangle in the Pearl River Delta incorporates Hong Kong and part of Guangdong Province of China. There has been some debate over the role of governments in promoting sub-regional economic zones, but Sijori and the Pearl River Delta zone are overwhelmingly market-driven as spillovers in the 1980s and 1990s from the city state economies of Singapore and Hong Kong. Comparable growth poles exist around Bangkok and Shanghai, but these cross provincial rather than national borders and are rarely included in lists of SRZs. Deliberate governmental attempts to promote new SRZs such as the East Asian Growth Area (EAGA, involving the southern Philippines, Sabah and Sarawak, Brunei, Sulawesi and the Moluccas) or the Tumen River Area Development Programme have experienced little economic success, although the Tumen project may have played a small but positive role in reducing political tensions in north-east Asia.⁹ Conversely, the existence of a regional organization, the Association of Southeast Asian Nations (ASEAN), may have provided the necessary political stability and economic trust for a cross-border phenomenon such as the Sijori SRZ to flourish where neighbours had been enemies a few decades earlier.¹⁰

An important distinction between SRZs and APEC's open regionalism on the one hand and discriminatory arrangements such as CUs or FTAs on the other hand, is that the former do not breach the GATT/WTO unconditional MFN principle. Being treated as the most favored nation by all WTO members is an important reason for joining the organization; existing WTO members will not look favorably on Central Asian countries trying to bring discriminatory arrangements with them when they accede to the WTO, and the Central Asian countries are likely to have to treat CU/FTA membership and WTO membership as alternatives even though the latter technically allows for the former under Article XXIV. Additionally, WTO members have resort to a complaint and dispute settlement mechanism if they believe their exports are being unfairly treated by another member, so that any backdoor discriminatory arrangement is likely to be queried. Against these rights, WTO members have obligations towards imports from other members. The obligations impose restrictions on countries' ability to set trade policies as they please, but economists argue that for a small country the restrictions are in the country's own self-interest because they incorporate the optimum trade policy, ie. one which is transparent and relies on trade taxes rather than more harmful trade barriers.

Among the Central Asian countries only the Kyrgyz Republic has been admitted to the WTO. As part of the accession negotiations the Kyrgyz Republic, which already had the most liberal trade regime in the region, agreed to reduce tariffs to below ten percent within a few years and to report annually on its privatization program. Some commentators have argued that such accession negotiations require administrative resources that are limited in poor countries in transition from central planning and hence discriminate against their speedy admission.¹¹ It has also been observed that the demands made by existing WTO members on acceding countries are more strict than those required of current members, eg. developing countries in the WTO have average tariffs on manufactures of over twenty percent but new members are being set targets of ten percent or less and subsidy or state-trading regimes are being more rigorously analysed for applicants than for incumbents.¹²

2. Trade within the Commonwealth of Independent States (CIS)

Within the Soviet Union, the Central Asian republics were open economies, whose trade was overwhelmingly oriented towards intra-USSR trade. One indication of this is the comparison with the Canadian provinces made by the IMF using trade flows from the 1980s; the Canadian provinces and the Central Asian republics had roughly equal trade to GDP ratios, but the share of intra-USSR trade in the Central Asian republics' trade was 85-90 percent while for the nine largest Canadian provinces intra-Canadian trade was 38-61 percent of their total trade (Table 1). The degree of economic integration within the USSR may even be understated by such a portraiture, given the high degrees of specialization and dedicated supply chains and automatic credit facilities received by the Central Asian republics.

After the sudden disintegration and dissolution of the USSR in the second half of 1991, the new independent states of Central Asia were primarily concerned with nation-building and addressing the immediate macroeconomic problems of declining output and hyperinflation. Trade policies consisted of *de facto* maintenance of existing trade links, and even when new tariff schedules or other trade restrictions were introduced they were not imposed in any systematic way on trade with other former Soviet republics. In order to support this policy of maintaining existing trade flows, the new independent states also clung to the common currency, even though membership in the ruble zone made independent monetary policies impossible and left the Central Asian countries dependent on Russia for currency supplies. During 1993, first the Kyrgyz Republic in May, and then Turkmenistan, Kazakstan and Uzbekistan in November left the ruble zone.¹³

The successor organization to the USSR was the Commonwealth of Independent States (CIS). The CIS, conceived by Russia as a framework to maintain post-Soviet ties and as a political counter to eastward expansion of the EU and of NATO, has had no explicit economic role during the 1990s, although there have been several moves to create regional trading arrangements within the CIS. Between 1992

and 1994 CIS politics were largely defined by regional conflicts, in all of which (with the exception of Tajikistan) Russia opted for a unilateral solution. Since 1995 the decline in Russian power, exposed by the Chechen conflict, has been accompanied by a freezing of the main intra-CIS conflicts and the emergence of alternative political initiatives, such as GUAM (Georgia-Ukraine-Azerbaijan-Moldova, subsequently extended to include Uzbekistan and re-named GUUAM), which exclude Russia.

Many agreements to form economic arrangements within the CIS have been signed but had zero practical impact. This was especially true in the final year of the ruble zone, with Armenia, Azerbaijan, Belarus, Kazakstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan and Uzbekistan signing an agreement in September 1993 to set up an economic union; Georgia signed some of the provisions and Ukraine became an associate member, so that all of the non-Baltic former Soviet republics except Turkmenistan were in principle committed to some form of intra-CIS economic arrangement.¹⁴ Neither this nor subsequent proposals or agreements involving a majority of CIS members made any practical progress.

The only major economic integration process within the CIS has been the union initiated by Belarus with Russia and formally signed in May 1997, which appears to be a special case based on the non-reform of the Belarus economy and decisions of the Belarussian leadership personality. In the mid-1990s Kazakstan appeared the most positively inclined of the Central Asian countries towards a customs union centred on Russia, and this proposition was articulated by President Nazarbayev in summer 1994 as a Euro-Asian Union.¹⁵ Kazakstan subsequently joined Russia and Belarus in signing a customs union agreement in January 1995, although that tripartite customs union has yet to be implemented and in September 1996 Nazarbayev indicated that Kazakstan would leave the customs union when it accedes to the WTO.¹⁶ The Kyrgyz Republic signed on to the customs union in March 1996, after which it became known as the Union of Four, but the impact of the Kyrgyz Republic's WTO accession in July 1998 on its participation in the customs union remains unclear.¹⁷ Tajikistan signalled its

intention of joining the Union of Four in April 1998. The Union of Four has reached agreements on trade facilitation measures such as customs clearance rules, transit conditions and excise tax policy, but has not taken measures to activate a formal customs union.

In sum, there have been many bilateral arrangements announced but not implemented by the Central Asian countries, and *de facto* implementation of their trade and tax policies has often discriminated in favour of intra-CIS trade. Apart from the four-country customs union described in the previous paragraph and the CAEU, however, no discriminatory trade arrangement has been intentionally introduced and deliberately implemented. There are also a number of sub-national agreements between regions of CIS countries, negotiated independently between, for example, Russian regions and national or regional authorities in Kazakhstan, the Kyrgyz Republic and Turkmenistan. Such agreements are extremely difficult to monitor in any systematic manner, but their economic significance does not appear to be great.

Some trade facilitation measures, similar reform packages (or adjustments in areas such as value-added tax administration) and, most of all, history conspired to make intra-CIS trade still important for the Central Asian countries during the 1990s. Table 2 provides roughly comparable trade data for the five countries for 1994-6. These are years for which trade was mainly being conducted at world prices on a hard currency basis, apart from Turkmenistan's natural gas whose export value collapsed in 1997.¹⁸ The intra-CIS share declined substantially over these years, especially for Uzbekistan, the most populous of the Central Asian countries, and can be expected to continue to drop. For Kazakhstan and Turkmenistan, critical developments will be construction of new oil and gas pipelines to non-CIS destinations. For the resource-poorer countries, trade diversification has been a slow process but the flow of gold from the Kyrgyz Republic's Kumtor mine¹⁹ and normalization of the political and economic situation in Tajikistan will accelerate diversification away from CIS trade

partners. On the other hand, there is little prospect of any offsetting forces leading to greater trade with Russia or the European or Caucasus CIS countries.

3. The Economic Cooperation Organization (ECO)²⁰

Outside the CIS, cooperation with Central Asia's southern neighbours, Iran, Pakistan and Turkey, moved fastest because the three countries already had a functioning regional organization and that organization was eager to welcome the Islamic republics of the former Soviet Union as new members as soon as they became independent countries. Iran, Pakistan and Turkey had founded the Economic Cooperation Organization (ECO) in 1985 to promote economic, technical and cultural cooperation.²¹ ECO is the successor organization to Regional Cooperation for Development (RCD), which was functional from 1964 to 1979 and whose charter, the 1977 Treaty of Izmir, remains the basic document of ECO. After the death of the Ayatollah Khomeini in June 1989 the Iranian leadership, as part of a general policy of liberalizing international economic relations and reintegrating Iran into the wider community, led initiatives to boost ECO's activities. The only real outcome was the 1991 Protocol on Preferential Tariffs, whose implementation after 1993 would be disappointing, but it was at this moment that the ECO members' northern Islamic neighbours became independent. The accession to ECO of the five Central Asian countries, plus Azerbaijan and Afghanistan, followed quickly.

The enlargement of ECO from three to ten members, ratified in November 1992, gave the organization new impetus. The accession of Afghanistan, Azerbaijan, Kazakstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan gave ECO a cultural cohesion, incorporating all of the non-Arab Islamic countries of western and Central Asia.²² The enlarged group contains 325 million people spread over almost eight million square kilometers. Most importantly in the present context, ECO provides a forum for discussion of regional disputes and for peaceful cooperation

among the original members and the newly independent member countries, including the Central Asian countries.

The expanded ECO offers a possible umbrella for facilitating trade among the Central Asian countries and their southern neighbours. The institutional capacity of ECO has been gradually increased. Annual meetings of senior officials and ministers in various areas have been established, underpinning the biennial summits of heads of state. The ECO Secretariat in Tehran moved to a new building in 1997 and by early 1999 had a staff of over fifty. Without denigrating the importance of talking shops or information sharing, however, the concrete achievements of ECO during the 1990s have been modest.

The Protocol on Preferential Tariffs was signed in May 1991, by which the signatories agreed to offer a ten percent preferential tariff reduction on selected items. Application of the Protocol was, however, disappointing; the lists of items were extremely limited, and even after national implementation began in May 1993 there were doubts that the preferential treatment was actually being applied. The ECO Committee on Preferential Tariffs met several times between 1993 and 1995, but was unsuccessful in persuading the signatories to extend their lists or to offer more substantial preference margins. The new members have shown little interest in acceding to the preferential tariff arrangements. After little progress had been made on this front by 1996, the ECO Secretariat took the initiative in trying to reorient attention to include discussion of the implications of the Uruguay Round and the World Trade Organization for the ECO region. This initiative was formalized in the Almaty Declaration at the 1998 ECO summit when all members were urged to take steps towards WTO membership.²³ In effect, the organization has abandoned regionalism in favour of multilateralism so far as trade policy is concerned.

The ECO members have committed themselves to establishing four regional institutions: a trade and development bank, a reinsurance company, an ECO shipping

company, and an ECO airline. After long negotiations, agreement was reached in January 1995 that the ECO Trade and Development Bank would be based in Istanbul, and the minutes of the Committee meeting included a strong statement of intent that the ECO reinsurance company should be based in Pakistan (now agreed to be based in Karachi). The time-consuming negotiations illustrate the difficulty in reaching agreement on regional institutions, both with respect to their functions and with respect to location. At the Third ECO Summit in Islamabad in March 1995 agreements on all four institutions were signed, but they have yet to be implemented.

ECO probably has greater potential in the area of trade facilitation than in these dirigiste projects of preferential tariffs and regional institutions. The 1993 Almaty Outline Plan, often referred to as one of ECO's basic documents, is a project-oriented plan for transport and communications development on a regional basis. At the 1995 ECO Summit the heads of state signed the ECO Transit Trade Agreement and an Agreement on the Simplification of Visa Procedures for the Businessmen of ECO Countries. Such trade facilitation measures could be important steps in promoting regional trade. The transit agreement was, however, only signed by eight countries, and the two non-signatories, Uzbekistan and Afghanistan, straddle important crossroads in the region; the unwillingness of these two governments to accept the principle of unhindered passage of goods in transit is a potential deterrent to intra-regional trade.²⁴

Despite the diplomatic activity and political claims sometimes made about ECO, its economic potential is severely limited by the similarity of the members' economies. All produce a rather limited range of primary products, centered on energy products, minerals and cotton, while their manufacturing sectors tend to also be heavily concentrated on a few items, notably cotton products and clothing. Despite attempts by Iran, Turkey and Pakistan to exploit their scale economies and greater diversification, their trade with the new ECO members has remained of minor significance. Table 3 presents estimates of intra-ECO trade flows in 1996. The data are clearly imperfect, as is reflected in the large discrepancies in some two-way flows between the amount

reported by the importing country and that reported by the exporting country, but the overwhelming impression is of small absolute values of trade flows and the generally tiny shares (given in parentheses) of ECO members' total trade which is with other ECO members.²⁵

The achievements of ECO during the 1990s have clearly been modest. Some of the ECO Summits, notably that of 1996 where the main debates featured disputes between Uzbekistan and Iran and delegates left a day earlier than planned, have been divisive. Nevertheless, it is an achievement of ECO to have kept such conflicts to the conference table, even as the Afghanistan conflict smoulders on with ECO members lining up as supporters or opponents of the Taliban. The best model for ECO is, perhaps, the Association of Southeast Asian Nations (ASEAN), which began life at a time of high tension between Malaysia and Indonesia and with the Indochinese wars as backdrop, but which oversaw three decades of unparalleled regional economic growth; ASEAN did not propel the growth but, by facilitating regional economic cooperation and by providing a talking shop to defuse potential conflicts, it played a contributing role.

4. The Central Asian Economic Union

In April 1994 the presidents of Kazakstan, the Kyrgyz Republic and Uzbekistan signed a treaty for the establishment of an integrated economic space. In March 1998, Tajikistan, which previously had observer status, became a full participant in the scheme, which has become known as the Central-Asia Economic Union (CAEU). The treaty envisions deeper integration and free movement of goods, services, capital and labour, but little progress has been made and on some specific priorities (eg. creation of a common agricultural market) the situation has deteriorated substantially since the dissolution of the USSR.²⁶

Trade among the five Central Asian countries is difficult to measure, with even more porous borders than others in Table 3. Nevertheless, it is fairly certain that such

trade has declined in relative importance during the 1990s. During the first half of the 1990s intra-CAEU trade declined in absolute value, and continued to do so even during the mid 1990s when overall trade had revived. Mutual exports between Kazakhstan, the Kyrgyz Republic and Uzbekistan declined from \$785 million in 1994 to \$664 million in 1995 and \$645 million in 1996, despite substantial growth in the three countries' overall dollar trade during these years.²⁷

In some respects, eg. the existence of an Interstate Central Asian Bank of Cooperation and Development founded in June 1994 with head office in Almaty and branches in Bishkek and Tashkent, the CAEU resembles a mini-ECO. The CAEU claims to have made achievements in tax harmonization and elimination of double taxation, and also covers some areas not dealt with by ECO, such as use of water resources and provision of ecological safety.²⁸ The CAEU secretariat in Bishkek is not comparable in size or support facilities to that of ECO in Tehran, but the CAEU's Interstate Council meets once a quarter and has a permanent Executive Committee.

Another overlapping arrangement is the Special Programme for the Economies of Central Asia (SPECA) launched by the Tashkent Declaration of March 1998 and supported by the two United Nations regional organizations, the Economic Commission for Europe (ECE) and the Economic and Social Commission for Asia and the Pacific (ESCAP). SPECA has five working groups, each headed by one of the Central Asian countries: transport (Kazakhstan), industrial restructuring and international competition (Uzbekistan), technical assistance with energy pipelines (Turkmenistan), energy and water resource management (the Kyrgyz Republic) and attracting direct foreign investment (Tajikistan). It is noteworthy that neither the CAEU nor SPECA is actively promoting preferential trade policies in the region.²⁹

5. Prospects for Greater Intra-regional Trade

The ability of the Central Asian countries to enter into preferential trading arrangements with their southern neighbours may be limited by some of their neighbours' existing commitments. Pakistan is a member of the South Asian Association for Regional Cooperation (SAARC), which has preferential tariff arrangements resembling those of ECO in their limited scope and lack of impact. There is a potential conflict between the requirements of SAARC preferential treatment and Pakistan's commitments under the ECO Protocol on Preferential Tariffs, but in practice both schemes are too limited to matter. For Pakistan, the SAARC preferences are even more of a dead letter than those of ECO, because trade with India (by far the largest SAARC economy) is subject to specific permission being granted for each transaction.

Turkey formed a customs union with the European Union which entered into force on 1 January 1996, and this treaty obligation limits Turkey's ability to alter tariff rates and other trade-related policies. Turkey notified the ECO Secretariat that its obligations towards the EU would override any ECO commitments.³⁰ Since then, however, Turkey's relations with the European Union have been unsettled. After the June 1996 election the new Turkish prime minister, Necmettin Erbakan of the Islamic Welfare Party, rejected prospects of joining the European Union, which he characterized as a Christian Club, but Erbakan was forced to resign in June 1997. The succeeding coalition which governed until December 1998 was more western-oriented, but a fundamental shift in Turkish-EU relations followed the EU's December 1997 decision to enlarge eastwards but not to admit Turkey, signalling a definitive move of Turkey to the back of a potentially long admission queue and representing a low point in Turkey's relations with the EU. Symptomatic of the poorer relations were the late 1998 diplomatic conflict with Italy over the latter's refusal to extradite Kurdish leader Abdullah Ocalan and subsequent lack of concern by Turkey for EU pleas for Ocalan not to face the death penalty in his trial .

Apart from Turkey's customs union with the European Union, the various regional trading arrangements described in this chapter have had little impact on actual trade flows. The preferential tariffs envisaged by ECO and SAARC have been so limited in preference margin and coverage as to be symbolic. Preferential arrangements within the CIS have been characterized by much rhetoric, but little or no action beyond the Russia-Belarus arrangement. In practice, intra-CIS flows have tended to be preferential during the 1990s because of inherited economic links and porous borders, but that situation is changing as the Soviet Union becomes a more distant memory.

The fundamental problem for proponents of increasing intra-regional trade is the similarity of the national economies. They all, with the possible exception of Turkey, export a fairly narrow range of primary products, concentrated in energy and mineral sectors and cotton, with considerable overlap in their export bundles. For all of the Central Asian countries their best trade prospects lie in their established CIS markets or in the high income industrialized countries of western Europe, North America and East Asia.

6. Conclusions

Subregional trade initiatives in Central Asia during the 1990s have been characterized by much activity but little serious institutional development. The most important regional connection is still with other members of the CIS, although this is more a result of history than of active discriminatory trade policies and intra-CIS trade is steadily diminishing in importance. The ECO has also played a role, encouraging and facilitating the Central Asian countries' trade with their southern neighbours, but trade among these similar economies remains a small share of total regional trade. Among the Central Asian countries themselves, there are many agreements of which the CAEU and SPECA have the highest profile, but the impact of these measures has not been strong.

The political reasons for the limited impact of the subregional initiatives are the widespread competition for influence and power which squeeze out cooperative efforts. The three original ECO members and, within Central Asia, Kazakstan and Uzbekistan are all locked in struggles for regional domination. In this context, the talking shops do have a role in defusing regional tensions; ECO in particular has provided a forum for rivals to come together, and the ECO Secretariat's pushes for trade facilitation do bring the competing nations closer.

The economic reason for the stunted growth of subregional cooperation is the similar nature of the national economies, all of which specialize in a narrow range of similar minerals, energy products and cotton. Thus, their trade flows are inevitably focussed on supplying markets outside the region, and their import supplies also tend to come from elsewhere.

Table 1: Comparison of Trade Flows, CARs and Canadian Provinces

	Total trade as % of GDP $((X+M)/2)/GDP$	Intra-regional trade as share of total trade
<u>CARs (1988)</u>		
Kazakhstan	33.9	86.3
Kyrgyzstan	45.2	86.9
Tajikistan	41.6	86.3
Turkmenistan	39.3	89.1
Uzbekistan	39.5	85.8
<u>Canadian Provinces (1984)</u>		
Alberta	39.1	60.3
British Columbia	33.6	38.3
Manitoba	40.3	61.0
New Brunswick	61.5	51.5
Newfoundland	45.6	59.1
Nova Scotia	49.9	54.0
Ontario	49.5	33.9
Prince Edward Island	50.5	75.5
Quebec	42.2	48.0
Saskatchewan	51.4	52.2

Source: International Monetary Fund, *Common Issues and Interrepublic Relations in the Former USSR* (Washington DC: April 1992), p.37.

Table 2: Exports and Imports of the Central Asian Republics, 1994-6 (millions of US dollars)

	1994		1995		1996	
	Exports	Imports	Exports	Imports	Exports	Imports
Kazakstan	3231 (58%)	3561 (61%)	4974 (53%)	3781 (69%)	6230 (56%)	4261 (70%)
Kyrgyz Rep.	340 (66%)	317 (66%)	409 (66%)	522 (68%)	506 (78%)	838 (58%)
Tajikistan	492 (93%)	547 (43%)	749 (34%)	810 (59%)	770 (43%)	668 (57%)
Turkmenistan	2145 (77%)	1468 (47%)	1881 (49%)	1364 (55%)	1693 (67%)	1313 (30%)
Uzbekistan	2549 (62%)	2603 (54%)	2821 (39%)	2748 (41%)	4211 (21%)	4712 (32%)

Source: CIS Statistical Committee data, as reported in Michael Kaser, "The Central Asian Economies 1991-1996," *Economic Survey of Europe in 1996-1997* (Geneva: United Nations Economic Commission for Europe, 1997), p. 205, and in Bakhtior Islamov, "Independent States of Central Asia: Reforms and Foreign Trade," paper presented at the Australian Association of Communist and Post-Communist Societies/Australia New Zealand Slavists' Association Conference on Communist and Post-Communist Societies, University of Melbourne, 7-10 July 1998, Table 4.

Note: Figures in the parentheses are the CIS share.

Table 3: ECO Trade Matrix for 1996 (millions of US dollars)

Importer Exporter	Afghan.	Azerbaijan	Iran	Kazakstan	Kyrgyz R.	Pakistan	Tajikistan	Turkey	Tk						
Afghanistan	-	-	6	0	0	33	1	0	-						
Azerbaijan	-	-	226	252	23	1	0	3	38	39	34				
Iran	24	189	76	45	6	32	3	33	286	22	12	134	806	125	
Kazakstan	6	10	62	112	112	140	12	4	61	42	52	101	39		
Kyrgyz Rep.	7	3	6	27	112	91	0	0	8	5	5	6	3		
Pakistan	15	11	16	54	10	0	4	4	5	1	63	83	7		
Tajikistan	1	0	4	2	12	18	9	6	1	0	8	3	10		
Turkey	2	240	240	298	284	164	176	47	48	78	71	4	5	66	
Turkmenistan	13	18	17	9	54	51	1	1	13	2	10	30	79	100	
Uzbekistan	20	4	22	24	120	89	84	131	8	1	68	275	174	58	44
ECO Total	-	-	770	(5.1%)	554	(9.5%)	335	(37.6%)	398	(3.3%)	375	(-)	1197	(2.7%)	325

Notes: in each cell the first figure is exporting country data and the second figure is importing country data; zero indicates data not given in the source; Pakistan data are for the 1996-7 fiscal year; Tajikistan data are for exporting country data and column totals are importing country data, and the figures in parentheses are the countries' total exports and imports respectively; the two grand totals are sums of the reported data.

Source: Richard Pomfret, *Central Asia Turns South? Trade Relations in Transition* (London UK: Royal Institute of International Affairs, Washington DC: Brookings Institution, 1999), Table 8, based on data from the Economic Cooperation Organization *on the ECO Member States for the Year 1997* (Tehran, 1998).

Richard Pomfret has been Professor of Economics at the University of Adelaide in Australia since 1992. After receiving his PhD from Simon Fraser University (Canada), he worked at the Institut für Weltwirtschaft (Kiel, Germany), Concordia University (Montréal), and the Johns Hopkins University School of Advanced International Studies (Washington DC, Bologna and Nanjing). In 1993 he was seconded to the United Nations Economic and Social Commission for Asia and the Pacific for a year, acting as adviser on macroeconomic policy to the Asian republics of the former Soviet Union. He has written thirteen books, including *Investing in China 1979-1989; Ten Years of the Open Door Policy* (1991), *The Economies of Central Asia* (1995), *Asian Economies in Transition* (1996) and *The Economics of Regional Trading Arrangements* (1997).

Footnotes

¹ Michael Kaser reports that the share of the Central Asian countries' trade with CIS partners fell below half for the first time in 1996; Michael Kaser, "The Central Asian Economies 1991-1996," *Economic Survey of Europe in 1996-1997* (Geneva, United Nations Economic Commission for Europe, 1997), pp. 179-211.

² Tajikistan has sustained its imports in large part by running up debts with Russia. In 1996, Tajikistan had the highest debt/GDP ratio of any former Soviet republic, 84%, mainly war-related concessional loans from Russia; see Isham Kapur and Emmanuel van Mensbrugge, "External Borrowing by the Baltics, Russia and other Countries of the Former Soviet Union: Developments and Policy Issues", *IMF Working Paper WP/97/72* (Washington DC: International Monetary Fund, 1997).

³ There is virulent competition among the original three ECO members for economic, political and cultural influence in Central Asia. The economic struggle is in part for the Central Asian countries' markets, but it is most apparent in competition to provide routes to sea ports. The cultural conflict centres on the different branches of Islam practised in Iran and in Pakistan, versus the more secular Islamic state represented by Turkey. There is also a linguistic dimension with Turkey claiming a natural kinship with other Turkic groups, which include the Azeris, Turkmen, Uzbeks, Kyrgyz and Kazaks, as well as the Uighurs of western China, while the Tajik language is closely related to Persian. The political struggle in the 1990s has been most acute in the Afghan and Tajik civil wars, where Pakistan, Iran, Uzbekistan and other countries have become more or less closely identified with combatants.

⁴ This is not to deny the deep suspicion of world markets harbored by many policymakers in the new independent states. Many policies introduced in 1992-3, notably export restrictions to prevent goods from being sold too cheaply to foreigners,

were based on poor understanding of market processes and poor assessment of countries' natural resource wealth, but the learning curve was steep.

⁵ Richard Pomfret, *The Economics of Regional Trading Arrangements* (Oxford UK: Clarendon Press, 1997).

⁶ Ian McLean, "Trans-Tasman Trade Relations: Decline and Rise" in Richard Pomfret ed., *Australia's Trade Policies* (Melbourne, Australia: Oxford University Press, 1995), pp. 171-89; Robert Scollay, "Australia-New Zealand Closer Economic Relations Agreement" in Bijit Bora and Christopher Findlay eds., *Regional Integration and the Asia-Pacific* (Melbourne, Australia: Oxford University Press, 1996), pp. 184-96.

⁷ Andrew Elek, "APEC Beyond Bogor: An Open Economic Association in the Asia-Pacific Region," *Asia-Pacific Economic Literature*, Vol.9, No.1 (May 1995), pp.1-16; C. Fred Bergsten, "Open Regionalism," *The World Economy*, Vol.20, No.5 (September 1997), pp.545-65.

⁸ Richard Pomfret, "Sub-Regional Economic Zones" in Bijit Bora and Christopher Findlay eds., *Regional Integration and the Asia-Pacific* (Melbourne, Australia: Oxford University Press, 1996), pp. 207-22; M.H. Toh and Linda Low, eds., *Regional Cooperation and ASEAN Growth Triangles* (Singapore: Time Academic Press, 1993).

⁹ The Tumen project includes North and South Korea, plus parts of China, Russia and Mongolia; see Richard Pomfret, "The Tumen River Area Development Programme," *Boundary and Security Bulletin*, Vol.5, No.4 (Winter 1997-9), pp.80-8.

¹⁰ Richard Pomfret, "ASEAN: Always at the Crossroads?" *Journal of the Asia Pacific Economy*, Vol.1, No.3 (1996), pp.365-90.

¹¹ Constantine Michalopoulos, "WTO Accession for Countries in Transition," *World Bank Policy Research Paper No.1934* (Washington DC: The World Bank, June 1998).

¹² Rolf Langhammer and Matthias Lücke, "WTO Accession Issues," *Kiel Working Paper No.905*, Institut für Weltwirtschaft, Kiel, Germany, February 1999 (forthcoming in *The World Economy*).

¹³ Richard Pomfret, *The Economies of Central Asia* (Princeton NJ: Princeton University Press, 1995) summarizes the Central Asian republics' trade patterns before 1992 and analyses their withdrawal from the ruble zone during 1993. Uzbekistan initially issued a temporary currency, the sum coupon, in November 1993, which was replaced by a national currency in July 1994. Tajikistan did not introduce a national currency until May 1995.

¹⁴ Georgia and Turkmenistan only formally joined the CIS in December 1993. Turkmenistan, although not signing the economic union agreement, had the tightest intra-CIS links among the Central Asian countries because its natural gas exports went overwhelmingly to CIS destinations due to the nature of the pipeline system.

¹⁵ Yelena Kalyuzhnova, *The Kazakstani Economy: Independence and Transition* (Basingstoke UK: Macmillan, 1998), pp. 49-50

¹⁶ Mark Webber, *CIS Integration Trends: Russia and the Former Soviet South* (London UK: The Royal Institute of International Affairs, London UK, 1997), p. 56. Kazakstan also signed a bilateral customs treaty with Russia in August 1995, although its implementation status is unclear.

¹⁷ The tariff bindings contained in the Kyrgyz Republic's WTO Accession Protocol (tariff rates of less than ten percent within a few years of accession) are far more stringent than external tariffs being proposed by other members of the customs union,

so that the most that the Kyrgyz Republic may be able to undertake in a regional trading arrangement with Russia, Belarus and Kazakstan is for the Kyrgyz Republic to have a free trade area agreement with the other three; see Rolf Langhammer and Matthias Lücke, “WTO Accession Issues,” *Kiel Working Paper No.905*, February 1999 (forthcoming in *The World Economy*), fn.29.

¹⁸ In 1996 natural gas accounted for three-fifths of Turkmenistan’s exports and only 9% were paid for in hard currency, while 56% were paid for by barter and 33% were recorded as arrears, with the export receipts on the current account offset by entries into the capital account of the balance of payments as claims on Ukraine, Georgia, Azerbaijan and Armenia. These notional foreign assets are unlikely to ever be realized, and in 1997 when Turkmenistan finally cut off gas supplies to countries with little prospect of paying their bills, the total export value plummeted from \$1693 million to \$759 million

¹⁹ The Kumtor mine is believed to be the eighth largest gold deposit in the world and is being developed by Cameco of Canada in a joint venture with the Kyrgyz Republic; see IMF Staff Country Report No. 98/8, *Kyrgyz Republic: Recent Economic Developments* (Washington DC: International Monetary Fund, 1998), p. 30

²⁰ This section draws heavily on Richard Pomfret, *Central Asia turns South? Trade Relations in Transition* (London UK: Royal Institute of International Affairs, and Washington DC: the Brookings Institution, 1999).

²¹ For historical background on ECO, see Marita Jägerhorn, “The Economic Cooperation Organization (ECO): Potentials and Prospects of Economic Cooperation in Central and West Asia”, *Ministry of Trade and Industry, Finland, Studies and Reports 29/1993* (Helsinki, December 1993); S.M. Haider, *Pakistan, Central Asia and the Region: Prospects of Regional Cooperation* (Lahore, Pakistan: Progressive Publishers, 1994); Bruno de Cordier, “The Economic Cooperation Organization:

Towards a New Silkroad on the Ruins of the Cold War?" *Central Asian Survey*, Vol.15, No.1 (March 1996), pp. 47-57; Richard Pomfret, "The Economic Cooperation Organization: Current Status and Future Prospects", *Europe-Asia Studies*, Volume 49, No.4 (June 1997), pp.657-67.

²² The Turkish Muslim Community of Cyprus is not a member of ECO, but its representatives often attend ECO meetings.

²³ Pakistan, Turkey and the Kyrgyz Republic are WTO members. Kazakstan, Uzbekistan, Azerbaijan and Iran are at various stages in the process of establishing working parties leading to accession. Turkmenistan and Tajikistan are considering whether to initiate applications.

²⁴ At the Fifth ECO Summit held in Almaty in May 1998, Uzbekistan again refused to sign a much watered down transit agreement. Even when international norms on transit are accepted, transit charges can be an impediment to trade. Kyrgyz exports passing through Kazakstan *en route* to Russia, for example, are subject to a \$300 charge on all trucks and, for trucks whose cargo is assessed at a value of \$3000 or more, an additional \$100 is levied by each oblast through which the truck passes; see Mohinder S. Mudahra, "Kyrgyz Republic: Strategy for Rural Growth and Poverty Alleviation," *World Bank Discussion Paper No.394* (Washington DC, 1998), p. 64.

²⁵ The major reasons for the data discrepancies are the unmonitored intra-CIS borders, the prevalence of small traders in supplying Central Asia's imports (shuttle traders) and illegal trade (e.g., in narcotics). For discussion of intra-ECO trade flows see the source to Table 3.

²⁶ Since independence, Uzbekistan has been pursuing a policy of increasing grain self-sufficiency, which reduces trade with its grain-exporting neighbour Kazakstan.

²⁷ See Kaser, "The Central Asian Economies 1991-1996", p. 206.

²⁸ This sentence draws on a presentation by Dr. N. Aitmurzaev of the CAEU Executive Committee, made to the Conference for the Development of Central Asia held in Urumqi, China, in September 1998. On the CAEU, see also Boris Rumer and Stanislav Zhukov, eds., *Central Asia: The Challenges of Independence* (Armonk NY: M.E. Sharpe, 1998), pp. 118-9.

²⁹ Other groupings involving Central Asian and neighbouring countries based on cultural or geographic affinity (eg. the Turkic Group, the Organization of the Islamic Conference, Black Sea and Caspian Sea organizations) have no explicit trade mandate. There is a confusing tendency for heads of state to announce decisions about closer ties for political reasons but then to ignore any follow-up; I make no attempt to document the complete history of such pronouncements and concentrate on ECO, the CIS and CAEU as the economically most significant (or potentially most significant) arrangements.

³⁰ Turkey has, however, taken positive steps since the mid-1990s to facilitate the shuttle trade, which are *de facto* targeted at CIS countries, especially Kazakstan. Around the Istanbul market of Liapeli and the town of Antalya special police units protect and assist shuttle traders, who have access to complaint bureaus, warehouse facilities, etc., and receive VAT exemption. Makhamat Khasanova (in Boris Rumer and Stanislav Zhukov, eds., *Central Asia: The Challenges of Independence* (Armonk NY: M.E. Sharpe, 1998), p. 184) quotes an Almaty business journal's March 1997 estimate that the shuttle trade brought in \$8-10 billion per year to Turkey.