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Enlargement and before Russian WTO  
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ENLARGEMENT AND BEFORE RUSSIAN WTO ACCESSION:  
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## **TRADE POLICIES IN CENTRAL ASIA AFTER EU ENLARGEMENT AND BEFORE RUSSIAN WTO ACCESSION: REGIONALISM AND INTEGRATION INTO THE WORLD ECONOMY**

This paper analyses the choices between regionalism and multilateralism, and the impact of WTO membership on the Central Asian countries. The five Central Asian countries have all remained open economies with high trade/GDP ratios, despite adoption, especially in Turkmenistan and Uzbekistan, of import-substitution policies.<sup>1</sup> Initially their trade was heavily oriented towards CIS markets as a result of inherited links and infrastructure, but by 1996 over half of their foreign trade was outside the old Soviet area. This trend has continued, although for all of them Russia remains the single most important trade partner. During the 1990s, although many regional trade agreements were signed and although the Kyrgyz Republic became a World Trade Organization (WTO) member in 1998, the Central Asian countries vacillated between pursuing regional and multilateral trade policy avenues.

In the early years of the twenty-first century the Central Asian countries' relationship to the WTO became a more pressing issue. In December 2001 China's long-running WTO accession negotiations were successfully concluded. Russian negotiations are also moving forward, and if they were also to be successfully concluded then the Central Asian countries would be in a situation in which their two largest neighbours were WTO members. At the same time the push towards regionalism is also affected by external events such as the European Union's deeper integration, symbolized by the appearance of euro banknotes in 2002, and the eastward expansion of the EU in 2004.

The first section outlines the trade patterns and policies of the Central Asian countries since independence. The second section describes the five countries' WTO status, considers what lessons can be drawn from the Kyrgyz Republic's WTO membership, and analyses the consequences for the Central Asian countries of Chinese and Russian WTO membership and the consequences of the current Central Asian applicants' (Kazakhstan, Tajikistan and Uzbekistan) own WTO accession. Section 3 reviews the large number of regional trade agreements which the Central Asian countries have signed - arrangements both among the Central Asian countries, and between Central Asian countries and their neighbours (Russia to the north, China to the east, and Iran and Turkey to the south) - and analyses why they have had little economic impact. The final section draws conclusions.

### **1. The Central Asian Countries' Trade Patterns and Policies**

The five Central Asian countries' trade patterns changed substantially over the 1990s, although the precise magnitudes are uncertain due to the variable quality of the trade data. Especially in 1992 and 1993 when the region was using a common currency, trade within Central Asia and with important trading partners such as Russia and Ukraine went largely unmonitored. Even after the establishment of national currencies and of functioning national customs services, the coverage of official trade statistics remained far from complete. Small-scale traders (referred to as shuttle traders in the region) account for a large amount of imported consumer goods and

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<sup>1</sup> Export/GDP ratios estimated by World Bank (2004, 9) staff with 2000 data were: Kazakhstan 59%, Kyrgyz Republic 42%, Tajikistan 81%, Turkmenistan 63% and Uzbekistan 25%.

other trade, but the recording of this trade is uneven.<sup>2</sup> Illegal trade is also important with widespread smuggling and with the Afghanistan-originating drug trade passing through Tajikistan and the Kyrgyz Republic and through Turkmenistan.

After the major shocks of the early 1990s, according to official import and export data reported by the IMF (Table 1), trade recovered in the Central Asian countries in 1994-7. In both the Kyrgyz Republic and Tajikistan, per capita values remained small and declined after a 1997 peak. The relatively superior export performance of Kazakhstan and Uzbekistan in the mid-1990s was due in part to favourable energy and cotton prices, and their divergent experience after 1997 is partly explained by the drop in world cotton prices since 1996 and booming oil prices since 1999. Turkmenistan's exports are dominated by energy products and the 1995-6 values are inflated by over-reporting of natural gas exports to CIS destinations which were not paid for (the invoice value was recorded as exports, while the accumulating payment arrears were recorded as foreign assets); recognizing that the bills would never be paid in full, Turkmenistan stopped supplying gas in March 1997, after which export values (and GDP) collapsed until the flow was resumed in March 1999.<sup>3</sup>

Table 2 presents Islamov's reconstruction of trade shares by destination. The initial values illustrate the overwhelming orientation to former Soviet markets at the start of the 1990s. By 1996 over half of the Central Asian countries' international trade was with non-CIS countries (Kaser, 1997, 179). The lead was taken by Uzbekistan, and reflects primarily the ability to sell cotton on world markets.<sup>4</sup> The other large country, Kazakhstan, was slower to diversify markets, unsurprisingly given its reliance on oil pipelines and mineral-processing links and its proximity to Russia, but the CIS share of Kazakhstan's trade had fallen to half in 1997 and dropped substantially further in 1999 during the export boom following devaluation of the currency. Only Tajikistan remains significantly dependent on CIS suppliers, and this largely reflects geopolitical and military considerations as unrequited imports are provided by Russia and Uzbekistan.

The Central Asian countries' tariff schedules have, in general, been fairly liberal (Table 3) and without great variance, although this has not been consistently true. The Kyrgyz Republic has bound most tariffs at ten percent as part of commitments made during WTO accession negotiations, and actual tariffs in 2002 averaged half of this level. Kazakhstan also has had a liberal trade policy since mid-1996, when export duties were removed and the average tariff on imports fell to

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<sup>2</sup> Pomfret (1999, 32n) reports official estimates from Kazakhstan of shuttle trade accounting for a quarter of total imports in 1995, a third in 1996 and over four-fifths in 1997. It cannot be assumed that official data understate trade by a constant percentage, because the share of informal trade varies across countries and across periods. Uzbekistan's vibrant bazaars and shuttle trade were brought under tighter state control and heavily taxed in 2000-1 ostensibly to protect consumers from shoddy imported goods, but whether this reduced the small traders' activity or simply pushed it further underground is uncertain.

<sup>3</sup> Turkmenistan's economic data are the least reliable in the CIS. According to other sources (reported in Pomfret, 2001, 158), gas exports fell from about a billion dollars in 1996 to \$70 million in 1997, and this coincided with a poor cotton harvest due to which cotton exports fell from \$332 million in 1996 to \$84 million in 1997.

<sup>4</sup> Breaking non-CIS trade down by country is not very interesting, because most exports went to cotton exchanges in the UK or Switzerland from whence the final destination was unknown (and of little concern to Uzbekistan). Kazakhstan's oil also becomes anonymous once it leaves the country; in 2002, according to the IMF *Direction of Trade Statistics*, over a fifth of Kazakhstan's exports went to Bermuda.

twelve percent; the average tariff had fallen below eight percent by 2002, but there are recurring complaints of *ad hoc* impositions which make trade policy less predictable. Uzbekistan's July 1995 tariff schedule had an average tariff of eighteen percent, but included some high rates.<sup>5</sup> Both Turkmenistan and Tajikistan also levy protective tariffs as well as imposing a range of export restrictions (mainly in the form of surrender requirements on foreign exchange earnings).

Episodes of illiberal policies have involved tariffs, non-tariff barriers to trade, and restrictions on access to foreign exchange. Uzbekistan in 1996 and Turkmenistan in 1998 responded to balance of payments difficulties by reintroducing foreign exchange controls, which made other import restrictions largely irrelevant.<sup>6</sup> Kazakhstan suddenly raised duties on intra-Central Asian trade in response to its 1998 crisis.<sup>7</sup> Border crossings have been temporarily closed, and, because such actions are often unpredictable, they may be discovered only upon arrival at the border. Customs officials operate with considerable discretionary power, and bureaucratic requirements impose substantial costs (especially for importers into Uzbekistan since the removal of exchange controls late in 2003). In October 1999, Kazakhstan passed legislation requiring labelling of all imports in both Russian and Kazakh, which could become a significant non-tariff barrier, although its implementation has been postponed. In Tajikistan, the central government does not exert physical control over the entire national territory, and it has lost control over some border regions for lengthy periods.

Actual collected customs duties have often been less than legislated tariffs. In the initial post-independence years borders within the former Soviet Union were lightly policed, and goods crossed with little regulation. In addition numerous preferential trading arrangements among the Central Asian countries or with neighbours both within and outside the former USSR have been signed, although these appear to have been rarely implemented (see section 3).

In sum, with all the reservations noted in this section, the Central Asian countries are open economies. The two countries with the most restrictive barriers to

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<sup>5</sup> Uzbekistan had applied duties of up to one hundred percent on automobiles to protect the UzDaewoo joint venture.

<sup>6</sup> The Kyrgyz Republic, in March 1995, and Kazakhstan, in July 1996, have accepted Article VIII commitments to the International Monetary Fund, guaranteeing full current account convertibility and non-discriminatory currency arrangements. In early 1996 Uzbekistan had committed to formally adopting Article VIII, and its currency was *de facto* convertible, but the commitment was abandoned and controls introduced in the second half of 1996. Although frequent declarations of intent were announced in the late 1990s and early 2000s, the introduction of currency convertibility was delayed until October 2003. Turkmenistan made circulation of foreign currencies illegal in December 1995, although the small private sector had reasonable access to foreign currency and the official and curb rates were close together until the second half of 1998, when tight exchange controls were introduced.

<sup>7</sup> After the August 1998 Russian crisis, which hit Kazakhstan hardest among the Central Asian countries, Kazakhstan introduced a 20% value-added tax on all personal imports from Russia, the Kyrgyz Republic and Uzbekistan, and then in December 1998 enacted a law on "Measures to Protect the Domestic Market from Imported Goods". Under this law, special tariffs as high as 200% were imposed on a number of goods imported from the Kyrgyz Republic and Uzbekistan in February 1999, when a number of other restrictions such as import quotas on cement imports from the Kyrgyz Republic were also introduced. In April 1999 the 200% February tariffs were eliminated, but new licensing procedures, transit fees and mandatory deposits on imports from the Kyrgyz Republic and Uzbekistan were introduced and the Kazakh tenge was floated, which led to an effective fifty percent devaluation. Also in early 1999, Uzbekistan tightened its foreign exchange controls and introduced a 5% tax on all purchases of foreign exchange. Turkmenistan closed the commercial banks' foreign exchange window in December 1998, and enacted legislation requiring all export and import contracts to be approved by the State Commodity Exchange.

trade, Turkmenistan and Uzbekistan, are necessarily trading nations because they have such obvious comparative advantages in natural gas and in cotton. The Kyrgyz Republic and Tajikistan are open in terms of low trade barriers, but the volume of their international trade is limited by their relative resource scarcity and by their landlocked status and difficulty of transiting neighbours. Kazakhstan is the biggest trading nation, and the gap is widening as the country rides an oil boom driven by new discoveries as well as high world oil prices.

## **2. The World Trade Organization**

WTO membership would appear to be a natural institutional counterpart to economic openness. In the 1990s, however, the Central Asian countries were suspicious of international obligations which placed constraints on their policy autonomy. They were happy to join the United Nations as a signal of nationhood, and to join the IMF and World Bank and the regional development banks as potential sources of capital, but apart from the Kyrgyz Republic they held back on WTO accession. For Turkmenistan, this attitude remains even in 2005, as the President views WTO membership as incompatible with the country's neutrality.

The first part of this section describes the current WTO status of the five Central Asian countries. The second part examines the experience of the only Central Asian country to have joined the WTO. The remaining parts analyse the consequences for the Central Asian countries of China's WTO accession in December 2001, Russia's expected WTO accession, and the accession of the Central Asian countries currently negotiating WTO membership.

### **(a) WTO Status**

With low average tariffs, the main obstacle to WTO membership has been Central Asian governments' unwillingness to formally abjure all of the non-tariff barriers described in the previous section. So far, only the Kyrgyz Republic among the Central Asian countries has joined the World Trade Organization (WTO), which it did in 1998 (Table 4). Kazakhstan's application appears to be fairly far-advanced. Uzbekistan's accession process is at an earlier stage than Kazakhstan's. Tajikistan applied for WTO membership in 2001. Turkmenistan has not made an application.<sup>8</sup>

The Kyrgyz Republic was the first Central Asian country to apply for WTO membership. Given its liberal trade policies, including a low and even tariff structure and few non-tariff barriers, negotiations went smoothly and the country became the first former Soviet republic to join the WTO. In the transition country context, the Kyrgyz Republic was typical of a number of small countries with liberal policies whose accession negotiations were untroubling to existing members.<sup>9</sup>

Uzbekistan was the second Central Asian country to apply, and the Working Party on the accession of Uzbekistan to the WTO was established in December 1994. This was during a period of substantial reform of the Uzbekistan's economy which had been initiated in January 1994 with a purposeful macroeconomic stabilization package. The reforms, however, began to lose momentum and were substantially undermined by the reintroduction of rigid exchange controls in October 1996. The

<sup>8</sup> For more details on the Central Asian countries' WTO relations, see Pomfret (2003) and Michalopoulos (2003).

<sup>9</sup> Slovenia joined the WTO in 1995, Bulgaria in 1996, Latvia and Estonia in 1999, Georgia, Albania and Croatia in 2000, Lithuania and Moldova in 2001, Armenia in 2003.

reform slowdown was reflected in snail's pace progress through the WTO accession process. Uzbekistan submitted its Memorandum on the Foreign Trade Regime in September 1998 and replies to questions were circulated in October 1999. The first meeting of the Working Party took place on 17 July 2002. The October 2003 reforms, which included establishment of currency convertibility, may signal a change of direction which could accelerate the accession process.

Kazakhstan's Working Party was established in February 1996. Bilateral market access negotiations in goods and services commenced in October 1997, and are continuing based on revised offers in goods and services. The process slowed down in 1998 following the Russian Crisis and its contagion effects on Kazakhstan, but has been revitalized since 2001.<sup>10</sup>

In May 2001 Tajikistan lodged a formal request for accession. A Working Party was established at the WTO General Council meeting in July 2001. Tajikistan has not yet submitted a Memorandum on the Foreign Trade Regime, and the Working Party has not yet met.

### **(b) The Experience of the Kyrgyz Republic**

The Kyrgyz Republic's WTO experience has become a disputed element in trade policy debates elsewhere in Central Asia and in Azerbaijan. Opponents of WTO membership cite the Kyrgyz Republic's poor economic performance since 1998 as evidence of a harmful effect of WTO membership. Such an interpretation is difficult to prove or disprove empirically given the many other candidates for explaining the country's disappointing economic performance in the final years of the century. The 1998 Russian Crisis, Kazakhstan's large currency devaluation, and the Kyrgyz Republic's massive banking crisis (three of the country's four largest banks were liquidated in 1998 and 1999) were major negative shocks to the Kyrgyz economy which coincided with WTO accession. The weakened economy of the Kyrgyz Republic certainly failed to reap much in the way of immediate benefits from WTO membership, but it is hard to demonstrate that it suffered harm from accession.<sup>11</sup>

A more robust criticism of the Kyrgyz Republic's accession experience is that the negotiators, whether due to inexperience or by intent, failed to make transitional arrangements or gain exemptions that would have protected Kyrgyz interests. Some learning process is reflected in Kazakhstan's lengthier and more detailed WTO negotiations, and harder stance on some of the voluntary codes. The appropriate negotiating balance must reflect a country's preferences and compliance capabilities; immediate compliance may be problematic and a phasing-in period desirable.

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<sup>10</sup> Topics under discussion in the Working Party include agriculture, the customs system (and customs union arrangements), price controls, import licensing, industrial subsidies, sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT), transparency of the legal system and legislative reform, services and intellectual property rights (TRIPS). The common belief is that, because of the Kazakhstan economy's close trade links with Russia, Kazakhstan's WTO accession will follow very soon after that of Russia.

<sup>11</sup> Trend (2003, 55-60) contrasts the 7-9% GDP growth of 1996 and 1997 with the 2-5% growth in the years 1998-2001. The Azerbaijani report mentions the other negative shocks, but focuses on WTO accession as the main cause of disappointing post-1998 growth, alleviated only by exports from the Kumtor goldmine whose growth was independent of WTO status. In a study of twenty-five transition economies during the period 1990-8, Campos (2004) found no robust relationship between WTO membership and the rate of economic growth, although he did find a positive effect of WTO membership on domestic reform; see also, Bachetta and Drabek (2002).

It is, however, unlikely that WTO provisions would harm a small open economy, although specific interest groups in the country may lose out. The basic WTO principles, embodied in the General Agreement on Tariffs and Trade (GATT), are general in applicability, and, although every nation has its own specific features, they do not imply that the WTO principles need to be modified. A red herring for many CIS countries (and China) in their WTO accession negotiations has been the pursuance of developing country status in order to qualify for special and differential treatment. All of the evidence suggests that developing country status has been of little value to its beneficiaries.<sup>12</sup> On the other hand, the CIS countries have made little effort to shed their “transition” status.<sup>13</sup> The transition from central planning is no longer the defining feature or descriptive of the Central Asian countries’ economic systems, but “transition” status allows the countries to be treated as non-market economies in anti-dumping determinations. In sum, developing country status may be difficult to negotiate and is scarcely worth the effort, while transition status may be difficult to shed but in view of the salience of anti-dumping measures as protective instruments it is definitely worth the effort.

### **(c) Trade with China and the Impact of Chinese WTO Accession**

China joined the WTO in December 2001, over fifteen years after the application was lodged. The Chinese negotiations were affected by specific political factors, notably the lengthy delay following the June 1989 Tiananmen incident, which prevented conclusion of negotiations during the GATT era. The drawn-out negotiations meant that by the time they were concluded much of the necessary adjustment in China’s external trade policies had already taken place by the time of accession.<sup>14</sup> In the literature on China’s WTO accession there is little mention of the impact on the Central Asian countries. This is primarily because the Central Asian countries are minor trading partners or investment suppliers for China., and consideration of Central Asia arises largely in the context of energy supplies or security, neither of which has much to do with WTO status. China is more important for the Central Asian countries’ trade, although the numbers are still not large (Table 5).<sup>15</sup>

In the early 1990s trade between Central Asia and China grew rapidly from a very low base, although hard data are unavailable. The growth slowed in 1993-4 amid currency changes, and in the mid-1990s some Central Asian governments expressed concern about their markets being flooded by Chinese consumer goods,

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<sup>12</sup> Donor-determined schemes under the Generalized System of Preferences grant very limited preferential access to developing country exports, and even this can be withdrawn at short notice if the developing country actually succeeds in increasing its exports substantially.

<sup>13</sup> This may change since agreement was reached in 2002 as part of Russia’s WTO accession negotiations that it be treated as a market economy. Transition status allows the importing country to disregard actual prices in the alleged dumping country when calculating dumping margins and instead to use constructed values, which are often biased in favour of the import-competing industry’s claims.

<sup>14</sup> There is a huge literature on China and the WTO. The recent collection edited by Bhattasali et al. contains studies on the main aspects affecting the Chinese economy.

<sup>15</sup> Wiemer (2000) reports estimates of shuttle exports at \$300-600 million. Even with the highest estimates of shuttle trade, trade with Central Asia amounted to less than one percent of China’s total trade in the late 1990s. For Xinjiang Province, however, over half of international trade is with Central Asia. For Central Asia, trade with China is more significant, perhaps 5% of total international trade. The main items were iron and steel (\$202m.), copper (\$87m.), aluminium (\$53m.) and fuel (\$40m.) imports from Kazakhstan and shoe exports (\$80m) to Kazakhstan and the Kyrgyz Republic. Some commodity trade was dominated by bulk state purchases and could fluctuate from year to year, eg. Uzbekistan’s cotton sales to China fell from \$133 million in 1997 to \$29 million in 1998



while Chinese traders and potential investors worried about the insecurity of property rights in Central Asia. The evidence of the bazaars is that unofficial import of consumer goods from China continues to flourish. A growing trend, especially in the cities of Kazakhstan and the Kyrgyz Republic, is the presence of more or less permanent Chinese traders, suggesting increased volume of trade.

The potential for increased trade between Central Asia and China is substantial given their differing factor endowments and natural resources, but realizing the potential depends upon a favourable trade environment and improved physical infrastructure.<sup>16</sup> China's WTO accession could, given these favourable conditions, kick-start trade with Central Asia. Pressure to improve entry into the financial sector and to the logistics sector as a result of China's WTO entry commitments should reduce trading costs within China, with particular benefit to China's inland provinces such as Xinjiang. Such improvements could also facilitate international trade, including trade with Central Asia which is currently conducted to a large extent in cash and is hampered by prohibitive transport and other transactions costs.

#### **(d) The Impact of Russian WTO Accession**

Russia's WTO accession negotiations have progressed in fits and starts. Although the Working Party was established in 1993, little progress was made until after 2001. In 2002 the EU and USA both granted Russia market economy status, which reduces the scope for using constructed values in assessing antidumping duties, but concerns remain (especially in the EU) over Russia's subsidized energy prices. Agriculture and services are the other major sticking areas. Work commenced in 2004 on a draft Report of the Working Party, suggesting that negotiations were reaching the endgame stage.

Existing empirical studies of the economic impact of Russian WTO membership emphasise the benefits to Russia from increased investment and technology transfer.<sup>17</sup> This suggests that the main impacts on Central Asia will be investment diversion and increasing import demand. The former is likely to be minor because the amount of DFI in Central Asia is small, apart from energy investments in Kazakhstan and to a much smaller extent Turkmenistan (Table 6). The potential of benefiting from a larger Russian market will be felt most by Kazakhstan as the Central Asian country most heavily involved in trade with Russia.

For the Central Asian countries trade relations with Russia are substantially more important than their trade relations with China (Table 7). For Kazakhstan, the most important Central Asian trading nation with both countries, exports to Russia have been at least double those to China and imports from Russia have been several times larger than those from China; this last point may be slightly offset by the shuttle trade, but no estimates of the unofficial cross-border trade with China bring total imports close to the amount coming from Russia. The Kyrgyz Republic is the only

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<sup>16</sup> In response to high oil prices, China took the initiative in funding an oil pipeline from Kazakhstan to China on which construction began in 2004 and which will eventually impact on bilateral trade.

<sup>17</sup> Jensen, Rutherford and Tarr (2002), employing a computable general equilibrium model of the Russian economy, estimate long-run gains from WTO accession equal to over fifty percent of current consumption, and these mainly capture increases in total factor productivity associated with liberalization of foreign direct investment. Yudaeva (2003) reviews other studies. Lissovlik and Lissovlik (2004) and Babetskaia-Kukharchuk and Maurel (2004) use the gravity model to assess the impact of Russian WTO accession on trade flows.

one of the Central Asian countries for which the two large trading partners have been of roughly equal weight in recent years. For the three countries negotiating WTO membership, Russia is a significant trading partner in contrast to the small magnitudes of China trade.

#### **(e) Central Asian Countries' WTO Accession**

The most important benefit of WTO membership would be to place all Central Asian trade on a common basis of international trade law, and potentially to separate trade from politics. The benefits of WTO membership should be accentuated by China's accession in 2001 and by Russia's impending accession. If Russia's outstanding issues can be settled expeditiously, then formal membership is likely to occur in 2006. Kazakhstan's WTO accession has long been expected to be closely tied to that of Russia, due to the strong economic links with its northern neighbour.<sup>18</sup> Pressure would then be on Tajikistan and Uzbekistan to accelerate their accession negotiations. The Central Asian countries' accession would provide a common framework for formal trade policies and dispute resolution with respect to both intra-regional trade and trade with all of the region's economically important neighbours.<sup>19</sup>

Overall, the trade performance of the Central Asian countries has been disappointing and below potential. Apart from Kazakhstan's oil-driven post-1999 boom, the Central Asian countries' export growth since 1994 has been mediocre (Table 1). The explanation is a mixture of the destruction of intra-CIS trade due to the erection of borders, and the failure to realize the potential for trading in the major non-CIS markets. One indicator of the potential for international trade is the contrast between intra-Russian trade and international intra-CIS trade. Using a gravity model, Djankov and Freund (2002) estimate that trade among Russian provinces is around sixty percent higher than trade between CIS countries, *ceteris paribus*; this suggests the large orders of magnitude by which the Central Asian countries' trade could increase if the size of the border effect could be reduced. In World Bank (2004, 8), the actual trade flows are compared to those predicted from a gravity model of world trade flows; in 2001 all five Central Asian countries still traded more than predicted with CIS countries, and they mostly traded less than predicted with the EU, USA and China.<sup>20</sup> Clearly such estimates are no more than indicative in what remains a disequilibrium situation, but they suggest the potential benefits from reducing the costs of conducting international trade and facilitating access to the major world markets. The lack of a stable institutional environment for international trade is part of the high costs of doing trade with Central Asian countries, and WTO membership could alleviate these costs..

WTO accession could bring further benefits by encouraging liberal policies and punishing backsliding on commitments. Such an environment would help to attract foreign direct investment, as well as making domestic investment more attractive. With a positive domestic environment, WTO membership helps to ensure

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<sup>18</sup> A major agenda item at the Eurasian Community's May 2002 Moscow summit was coordination of the WTO negotiations by Russia, Belarus, Kazakhstan and Tajikistan. The Kyrgyz Republic has been threatening to withhold consent for Kazakhstan's accession until unresolved transit issues are settled, but that is unlikely to be an insuperable obstacle.

<sup>19</sup> Iran, Pakistan and Turkey, are all WTO signatories.

<sup>20</sup> The only exceptions to this last generalization are that Kazakhstan and the Kyrgyz Republic traded more than predicted with the EU and with China.

that a country can reap benefits from specialization and trade with diminished fear of protectionist responses in foreign markets.

Finally, WTO membership would grant some leverage to reduce existing illiberal policies. Most immediately, Uzbekistan and Tajikistan would want to join WTO member countries lobbying for reduced subsidies to cotton producers in the USA and EU.<sup>21</sup> Four West African countries have had success in publicizing the harmful impact of these subsidies on some poor countries' export earnings, and they formally introduced the Cotton Initiative into the Doha Development Agenda in April 2003 (Sumner, 2004). In October 2004 Brazil obtained a WTO ruling that some government subsidies to US cotton producers are illegal, and that case will spend the next year under appeal. Central Asian cotton-producing nations would broaden the coalition and highlight the iniquity of subsidizing rich country farmers to the detriment of poor farmers in areas with a comparative advantage in growing cotton.<sup>22</sup>

### **3. The Attraction of Regionalism**

This section reviews regional organizations which involve one or more of the five Central Asian countries and which contain or envision a trade component.<sup>23</sup> The subsections assess arrangements within the former Soviet space, new organizations with an exclusively Central Asian membership, relations with southern neighbours in the Economic Cooperation Organization, and relations with Russia and China within the Shanghai Cooperation Organization. The common question running through these assessments is why have the Central Asian leaders been willing to sign so many regional agreements and so unwilling to implement any preferential trading arrangements?

#### **(a) Arrangements within the former Soviet space**

The five Central Asian countries are all members of the Commonwealth of Independent States (CIS), but that organization has had little impact on trade conditions. The CIS was initially conceived as a framework in which to maintain economic ties among the Soviet successor states. In both the political and the economic spheres, however, the replacement of the Soviet Union by sovereign nations created conflicts that the CIS framework was unable to contain. Between 1992 and 1994, CIS politics were largely defined by regional conflicts in the Caucasus and in Tajikistan, in all of which (with the partial exception of Tajikistan) Russia opted for a unilateral solution. After 1994 Russia sought more multilateral approaches, but the

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<sup>21</sup> Direct assistance to cotton growers amounted to \$2.3 billion in the USA and \$0.8 billion in the EU in the 2001/2 season. Baffes (2004) estimates that these subsidies raised producer prices above the world price by 91% in the USA, by 144% in Greece and by 184% in Spain; the domestic supply response to these artificially high prices lowers world prices, and removal of the US and EU subsidies would increase world prices by as much as 71 percent.

<sup>22</sup> The cost to Central Asia of the subsidy-induced lowering of world prices is large. With world cotton prices 71% higher, the gain in export revenue would have added 3% to Uzbekistan's GDP, 6% to Tajikistan's GDP and 3% to Turkmenistan's GDP in 2000, even without any change in their output (Pomfret, 2004). These substantial benefits would accrue every year after abolition of the subsidies. Moreover, with more attractive world prices, the quantity of cotton exported would increase (by 5.8% in Uzbekistan according to Baffes's estimates), adding to the potential benefits.

<sup>23</sup> Other groupings involving Central Asian countries and their neighbours based on cultural or geographical affinity (eg. the Turkic Group, the Organization of the Islamic Conference, the Black Sea and Caspian Sea organizations) contain no trade mandate

decline in Russian power exposed by the Chechnya conflict and the freezing of the main intra-CIS conflicts encouraged the emergence of alternative political initiatives, such as the grouping of Georgia, Ukraine, Azerbaijan and Moldova (GUAM).

In the early years of the CIS many agreements to form economic arrangements were signed, but these had zero practical impact. This was especially true in the final year of the ruble zone. Armenia, Azerbaijan, Belarus, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan and Uzbekistan reached an agreement in May 1993 to set up an economic union, and they signed a formal treaty to that effect in September 1993. Georgia signed some of the provisions, and Ukraine became an associate member, so that the union included all the former Soviet republics except for the Baltic countries and Turkmenistan. The economic union treaty was supported by a host of other formal agreements on trade, payments, customs procedures and classifications, legal harmonization, and so forth, but neither the economic union nor subsequent proposals involving the CIS as a group made any practical progress (Sakwa and Webber, 1999, 386-90).<sup>24</sup>

The reality of intra-CIS economic relations is more complex. During the early 1990s, national borders were poorly monitored, and goods and people continued to pass fairly unimpeded. The situation gradually changed, especially over the second half of the 1990s, with the erection of formal customs posts at crossing points of what had been inter-republic borders. As mentioned in section 1, tariffs and other trade obstacles were introduced, although actual monitoring continued to be erratic and the distinction between legal and private levies by customs officials was not always transparent. By the early 2000s, several CIS member states had introduced visa requirements for citizens of other CIS countries.<sup>25</sup>

Much of the manoeuvring within the CIS has reflected strategic or political decisions, without economic content. Russia appears to view the organization as a vehicle for exerting political leadership in the former USSR, and sees the Collective Security Treaty (CST) as the main instrument. During the mid-1990s Russia attempted to re-establish its influence over Central Asia. Faced with a delicate ethnic balance between Kazakhs and Russians, President Nazarbayev of Kazakhstan tried to deflect the impending Russian dominance into a more cooperative structure by promoting a customs union. Uzbekistan and Turkmenistan were more overtly resistant to Russian regional designs, and Uzbekistan's withdrawal from the CST and Turkmenistan's neutrality reflected suspicion of Russian motives and a desire to distance themselves from Russian influence.<sup>26</sup> Turkmenistan adopted an autarchic

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<sup>24</sup> Olcott, Aslund and Garnett (1999, v) are even more dismissive of the CIS, which "has been a failure by almost any measure".

<sup>25</sup> The most important is Russia, which generally tolerated freedom of movement prior to the outbreak of the second Chechen war in 1999, but has since viewed illegal immigrants as a security risk. Russian officials estimate that perhaps four million illegal immigrants were working in Russia in 2002 (compared to 300,000 guest workers with proper documentation). New legislation, which took effect on 1<sup>st</sup> November 2002, expanded law enforcement officers' powers to deal with illegal immigrant labor. The summary deportations include an instance when 120 Tajiks were flown to Dushanbe in November 2002, and a similar incident a few days later involving 80 Tajiks.

<sup>26</sup> Uzbekistan withdrew from the CIS Collective Security Treaty in 1998, and aligned itself with the GUAM (Georgia, Azerbaijan, Ukraine and Moldova) grouping. Turkmenistan's President skipped CIS summits in Yalta in August 2000 and Sochi in August 2001, although he did attend the February 2002 informal summit at Chimbulak in Kazakhstan. Turkmenistan's relations with Russia were revived by Russian assistance in bringing Boris Shikhmuradov, a leading dissident who had been in exile in Moscow, to trial in Ashgabat in connection with the November 2001 assassination attempt on Turkmenistan's president.

political position, seeking United Nations guarantees of its neutrality.<sup>27</sup> Uzbekistan, after adopting a macroeconomic stabilization program in January 1994, by contrast became more prominent on the international stage as President Karimov sought to portray himself as the region's leader.<sup>28</sup> Concerns about potential Uzbek hegemony tended to push Kazakhstan and the Kyrgyz Republic, which also fears Uzbek irredentist claims to its territory, closer to Russia.

One of the leaders in trying to retain the CIS as a formal regional trading arrangement since the collapse of the ruble zone has been Kazakhstan's President, Nursultan Nazarbayev, who in 1994-5 advocated a Eurasian Union (Kalyuzhnova, 1998, 49-50). In a 1994 comment, President Nazarbayev, frustrated by lack of implementation of the many agreements signed by CIS members, observed that:

“Since the time of the establishment of the Commonwealth of Independent States, roughly 400 agreements have been adopted. However, as yet there have been no substantive results because individual national governments continue to reject certain provisions and interpret the meaning of the agreements in their own interest.” (Nazarbayev, 1996, 234).

In December 1994, Kazakhstan announced the formation of a customs union treaty with Russia and Belarus, which came into effect on 15 July 1995. The Kyrgyz Republic acceded in 1996 and Tajikistan in 1999 making it a Union of Five.

Despite the formal agreements between 1994 and 2000, there was little evidence of implementation by the Central Asian countries. Echoing Nazarbayev's earlier reservations about the CIS, the Kyrgyz Republic's President Akaev was quoted in 1999 as saying that the customs union agreements existed “on paper only” (Zhalimbetova and Gleason, 2001, 4). Indeed, members were operating in contradictory directions in terms of their actual policies. For example, it seemed likely that, as part of the custom union's common external trade policy, the tariff bindings which the Kyrgyz Republic agreed to in its 1998 WTO accession negotiations would be unacceptably low for Russia or Belarus, and a similar issue would arise if Kazakhstan were to join the WTO.<sup>29</sup>

In October 2000 the Union of Five was renamed the Eurasian Economic Community and a new treaty was signed in Astana, which came into effect in May 2001. The institutional framework has been strengthened in a bid to ensure better implementation. The organization is managed by an Interstate Council (chaired by President Nazarbayev), an Integration Committee, an Inter-Parliament Assembly (in Saint Petersburg) and by a Eurasian Community Court. The voting and financing formula gives Russia forty percent, Belarus and Kazakhstan twenty percent each, and the Kyrgyz Republic and Tajikistan ten percent each, with a two-thirds majority being

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<sup>27</sup> The UN General Assembly formally recognized Turkmenistan's neutrality in a resolution of 12 December 1995 (Freitag-Wirminghaus, 1998; Werner, 2001).

<sup>28</sup> In 1995-6 Uzbekistan became the most prominent regional ally of the USA. On occasion only Israel and Uzbekistan voted with the USA at the United Nations, and at the May 1996 ECO summit Uzbekistan's denunciation of Iran was so vitriolic that the summit ended a day earlier than planned. In July 1996 President Karimov was warmly received by President Clinton in Washington DC. For more details of Uzbekistan's evolving foreign economic policies, see Spechler (1999).

<sup>29</sup> In September 1996, when Kazakhstan's WTO accession seemed more imminent than proved the case, President Nazarbayev indicated that Kazakhstan would leave the customs union when it acceded to the WTO (Webber, 1997, 56). For both the Kyrgyz Republic and Kazakhstan, harmonizing their tariffs with Russia's would bring no benefits, and would lead to trade diversion and trade destruction; (a) Russian goods would have a larger preference margin, encouraging greater replacement of imports from the least-cost supplier by more costly Russian goods, and (b) higher external tariffs would encourage displacement of some imports by inefficient domestic producers.

required on “major policy issues”. Thus, Russia has veto power, but to implement new measures Russia will generally need the support of at least one other member, and at least two others on major policy issues. Within the new framework any member failing to abide by Community rules can be expelled.

The functional areas of the new Community differ little from those agreed within the earlier frameworks. The emphasis is on free intra-Community trade as well as a common market for labour and capital, common policies towards migration, and more general policy harmonization. A specific intention is to coordinate WTO accession negotiations, but even this attempt at a common external trade policy is dubious given that the Kyrgyz Republic is already a WTO member and that Belarus appears to have differing WTO goals than Russia. At the May 2002 summit in Moscow, Moldova and Ukraine were granted observer status, although President Nazarbayev as Chair emphasized that they would need to bring their legislation in line with that of the Eurasian Community’s existing members before closer integration could be discussed.<sup>30</sup>

In contrast to its predecessor organizations, the Eurasian Community is intended to operate as a regional international organization rather than as an inter-state agreement. At the political level it has very strong support from Kazakhstan, but the attitude of the other signatories is more lukewarm, and at the May 2002 summit Belarus President Alyaksandr Lukashenka openly criticized the implementation record of other members. Kazakhstan’s ambitious aspirations were reflected in statements by the governor of the National Bank of Kazakhstan, Grigori Marchenko, that the Community should aim to have a single currency and that “preliminary procedures for the introduction of a single currency might take only five to seven years”.<sup>31</sup> Later in 2002 Russian Prime Minister Kasyanov expressed hope that the Eurasian Community would adopt the Russian ruble as a common currency. In practice, however, Eurasian Community integration plans stalled in 2003.<sup>32</sup>

An alternative grouping among CIS countries emerged in February 2003 when the leaders of Russia, Belarus, Ukraine and Kazakhstan reached a tentative agreement to create a United Economic Space (UES). Russia promoted the UES concept, but the other three countries have bridled at suggestions of establishing supranational institutions and of adopting the Russian ruble as a common currency.<sup>33</sup> The UES concept is even less popular among other CIS countries who view it as an attempt by the economically strong to distance themselves from the economically weaker CIS countries. Both the Eurasian Community and the UES reflect a more assertive Russian stance in leading regionalism in the former Soviet space, but so far none of the intra-CIS arrangements has had much impact on trade relations.

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<sup>30</sup> The presumed eagerness of other states to join the Community was not shared, eg. President Kuchma was quick to deny any such desire by Ukraine.

<sup>31</sup> Quoted in the *International Herald Tribune*, sponsored section, 24<sup>th</sup>. April, 2002.

<sup>32</sup> For an optimistic analysis of the Community’s prospects, see Zhalimbetova and Gleason (2001). In June 2004, however, Belarus President Lukashenka told the Community’s General Secretary that “member states have got practically nothing from the Eurasian Community”.

<sup>33</sup> Even as Russia was promoting the UES concept at a political level, in 2002-3 Russia was raising tariffs and non-tariff barriers on specific imports from CIS countries, such as steel from Ukraine (Yudaeva, 2003). By the end of 2003 the UES appeared to have joined the list of defunct schemes, and the concluding communiqué of the January 2004 Astana summit between presidents Putin and Nazarbayev made no mention of the UES. At a May 2004 UES summit in the Crimea, however, Nazarbayev called for UES members to form a customs union, but Ukraine was not interested. During 2004 senior Russian officials also called for closer integration, using the ruble as a common settlement currency in the UES, although other countries were unresponsive.

### **(b) Organizations with an exclusively Central Asian membership**

During the second half of 1993 the presidents of Kazakhstan and Uzbekistan made several statements on the need to maintain a common economic space in Central Asia amid the discord of the CIS and imminent breakdown of the common currency area. After the collapse of the ruble zone in November 1993, the presidents of Kazakhstan, the Kyrgyz Republic and Uzbekistan agreed to create an integrated economic space, announced in the Tashkent Declaration of January 1994 and formalized in the Cholpon-Ata Treaty signed by the heads of state on 30<sup>th</sup>. April 1994. Initially called the Central Asian Economic Union, and intended to be modelled on the European Union, this organization evolved into the Central Asian Economic Community (CAEC), when Tajikistan joined in 1998.

The CAEC was viewed as a forum for resolving disputes within Central Asia, and also as a vehicle for promoting collaborative projects. The promotion of collaborative projects would require investment, and thus one of the main positive initiatives of the CAEC was the creation of an Interstate Central Asian Bank of Cooperation and Development, which was founded in June 1994 with head office in Almaty and branches in Bishkek and Tashkent. In the mid-1990s the Bank granted several small credits, such as \$300,000 to an Almaty firm producing electric meters, \$300,000 to an Uzbek firm producing blood products, and \$300,000 to a Kyrgyz firm manufacturing electric motors. The modest scale of these credits illustrates that the Bank was playing a primarily symbolic role. By January 1997, the participating countries had given the Bank only some two-thirds of its charter capital, and it was clearly incapable of drawing substantial external funds into Central Asia for investment in collaborative projects. In April 1997 Uzbekistan openly expressed its disillusionment with the Bank's work.<sup>34</sup> The CAEC member countries insisted that the Interstate Central Asian Bank of Cooperation and Development allocate resources proportionately to each country's contribution, so that little attention was paid to profitability or to externalities in the form of enhanced regional integration. Apart from the activity of the Interstate Central Asian Bank of Cooperation and Development, the CAEC had little in the way of practical achievements. Officials claimed to have made some contributions in tax harmonization and elimination of double taxation, but these are difficult to document, and the CAEC had little impact on intra-regional trade.

On 28<sup>th</sup>. February 2002 the four leaders proclaimed the Central Asian Cooperation Organization (CACO) as the successor to the CAEC. The Central Asian leaders have attempted to distinguish the CACO from its predecessor by emphasizing improved effectiveness. By some counts, at the CAEC meetings the Central Asian leaders passed over 250 resolutions, but the implementation record fell far behind the statements of intentions. The founding agreement of the CACO, however, continues to make lofty aspirations without paying much concern to institutionalizing implementation.

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<sup>34</sup> Uzbekistan's disillusionment was partly driven by the introduction in the previous autumn of strict exchange controls, which made it practically impossible for borrowers in Uzbekistan to access funds from the Bank which made hard currency loans and required repayment in hard currency. In the view of Gleason (2001, 1087), "The key obstacle to greater sub-regional economic cooperation at the end of the century was Uzbekistan" because of its inconvertible currency and protectionist trade policies. There is some truth to this, but the reasons for lack of cooperation were deeper and more widespread.

There was a flurry of activity after February 2002 under CACO auspices. The CACO summit in Dushanbe in October 2002 was combined with the meeting of the four heads of state of the International Fund to Save the Aral Sea. A regional business forum held its first session in November 2002 in Tashkent. As with the Eurasian Community, it is early days to judge whether implementation will in fact improve, but prospects may be even less favourable for the CACO in view of the political rifts between Central Asian leaders. In May 2004 Russia became a CACO member, but this seemed to be a sign of Uzbekistan-Russian rapprochement rather than a strengthening of the CACO.

As an alternative forum for regional cooperation, the Special Programme for the Economies of Central Asia (SPECA) was launched in 1998 with the support of the two United Nations regional organizations, the Economic and Social Commission for Asia and the Pacific (ESCAP) and the Economic Commission for Europe (ECE). The presidents of Kazakhstan, the Kyrgyz Republic, Tajikistan and Uzbekistan signed the Tashkent Declaration on 26 March 1998 creating SPECA, and in September 1998 Turkmenistan officially indicated its intention to sign the Declaration and to participate in SPECA projects.

The main purpose of SPECA is to support the Central Asian countries in strengthening their cooperation in order to both stimulate their economic development and facilitate their integration with the economies of Asia and Europe. Through consultation with the participating countries, five priority areas were identified and working groups set up as instruments to develop and implement the program in each priority area. SPECA's achievements have been limited. In part, this is because it has no self-funding mechanism. Two of the working groups have been single-project dominated, with their activities determined by available funding, while the other three working groups have little concrete to show (two have not even been set up, and the third's achievements are limited to bilateral issues between two countries).<sup>35</sup> The lack of achievement also reflects incomplete participation; Uzbekistan and Turkmenistan have not attended the meetings of the Regional Advisory Committee, the governing body of SPECA which is responsible for strategic decisions. The SPECA concept was formally adopted in April 2000 at the Eurasian Economic Summit in Almaty, a forum in which Kazakhstan, the Kyrgyz Republic and Tajikistan were participants and the other two countries were not.

The existence of SPECA is symptomatic of the proliferation of institutions for regional cooperation in Central Asia. If the CAEC/CACO had been an effective regional organization, there would have been little need for SPECA. Precisely because of the political obstacles to the smooth running of CACO, however, SPECA could have a positive role to play if it were to be accepted as a forum for technical cooperation, rather than having the political connotations of a European-Union-style organization that the CACO and Eurasian Community embody. In practice, however, SPECA has fallen victim to the political split in Central Asia, becoming identified with the Eurasian Community's Central Asian members and spurned by the other two Central Asian countries.

Although the formal agreements have had little impact to date, the CAEC/CACO and SPECA organizational structures survive because the need for

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<sup>35</sup> The energy and water group has been supported by a UN-funded project on efficient water use, the foreign investment promotion group has organized a conference in Dushanbe, the transport and border crossing group has served as a forum for discussion of transit issues between Kazakhstan and the Kyrgyz Republic, and the industrial restructuring and technical assistance with pipelines groups have not met.



regional cooperation is self-evident. Action on the Aral Sea and other water management issues has to involve all five Central Asian countries to be effective. Transport and transit matters also require some degree of regional cooperation, although the individual countries' needs vary and neighbouring countries should also be involved. The Central Asian regional organizations have, however, made no attempt to coordinate trade policy on a preferential basis, and by 2004 there was no effective regional organization composed solely of the five Central Asian countries.

### **(c) Relations with southern neighbours**

The Economic Cooperation Organization (ECO) offered to the newly independent countries a regional trading arrangement that could promote a southward reorientation of their trade from the patterns imposed within the Soviet economy. ECO's founding document is the 1977 Treaty of Izmir, signed by Iran, Pakistan and Turkey, although the organization was dormant between the 1979 Iranian revolution and 1985.<sup>36</sup> The three founding members then attempted to revive the organization by offering preferential tariff treatment to one another, but the list of eligible products was extremely restricted. At the eighth ECO summit in Dushanbe in September 2004, Iran proposed committing to an ECO free trade zone by 2015, but no practical steps were taken.

In 1992 the five Central Asian countries, together with Afghanistan and Azerbaijan, became members of the Economic Cooperation Organization. The members of the expanded organization contained over three hundred million people, and included all non-Arab Islamic countries west of India.<sup>37</sup> In 1993 ECO gained observer status at the United Nations General Assembly, and it was later accorded observer status at the WTO. In 1996 the Council of Ministers approved a restructuring, which included the establishment of a permanent ECO Secretariat in Tehran.

The ECO members have established eight regional institutions: a trade and development bank, an insurance institute, a shipping company, an airline, a reinsurance company, a chamber of commerce, a science foundation, and a cultural/educational institute. In 1995 it was agreed that the bank would be in Istanbul, and subsequently ECO issued a statement of intent that the reinsurance company would be located in Pakistan. Amidst bickering over location and funding, implementation proceeded slowly. The shipping company operated two leased multipurpose cargo vessels in the Persian Gulf and some ships plying the Caspian Sea, but despite being the sole profitable ECO project the shipping line ran into financial difficulties due to some ECO members' failure to make their contributions to the capitalization fund (Afrasiabi, 2000, part two).

The ECO heads of state have met frequently since 1992, and the summits have typically included grand declarations. The implementation record is, however, poor. This is highlighted by the history of the ECO transit agreements. Only eight countries signed the 1995 transit trade agreement, and the two non-signatories, Afghanistan and Uzbekistan, straddle some of the most important routes in the region. The agreement officially entered into force in December 1997, but by early 1999 only five national governments had ratified the agreement. The modified, and much watered down,

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<sup>36</sup> The Treaty was modified at a 1990 meeting in Islamabad and subsequently adopted as the Basic Charter of ECO. For a more detailed account of ECO's history, see Pomfret (1999).

<sup>37</sup> The Turkish Muslim Community of Cyprus is not a member of ECO, but its representatives have observer status.

1998 transit agreement had, as of mid-2000, only been approved by Azerbaijan and Tajikistan, whose geographical position makes them marginal countries to an ECO-wide transit arrangement. The unwillingness of key member countries to accept the principle of unhindered passage of goods in transit is a major obstacle to any concrete achievement by ECO.

As with the CAEC/CACO, the practical impact of ECO has been limited. In both organizations a fundamental obstacle to regional integration is the similarity of the member countries' economies, which all tend to be specialized on a small group of primary products (oil, gas, minerals, and cotton). Trade between the five Central Asian countries and their southern neighbours has expanded since 1992, admittedly from a low base and more slowly than many observers expected. However, it has done so on a non-discriminatory MFN basis rather than within a regional trading arrangement such as the ECO founding members appear to have envisaged in the early 1990s.

#### **(d) Relations with Russia and China**

Another overlapping configuration, dubbed the Shanghai Five, emerged from a meeting in 1996 of China, Russia, Kazakhstan, the Kyrgyz Republic and Tajikistan intended to demilitarize borders. At a summit in Dushanbe in July 2000, the Shanghai Five, with Uzbekistan as an observer, took up a number of themes related to trade facilitation as well as discussing issues such as countering Islamic terrorist groups. Although the countries had met since 1996 to discuss security issues, the extension into economic areas was a fresh departure in 2000, and the group changed their name to the Shanghai Forum and invited other countries to join them. At the June 2001 summit Uzbekistan became the sixth member and the group was renamed the Shanghai Cooperation Organization (SCO).<sup>38</sup> Despite the intention to cover matters such as trade facilitation, the subsequent history of the SCO has centred on political rather than economic matters.

The years 1998-9 saw the division of Central Asia into two opposing camps as Uzbekistan aligned with GUAM and Kazakhstan, the Kyrgyz Republic and Tajikistan joined Russia in the Union of Five and its successors. This division eased in 2000 and 2001, in part due to the incursion of Islamic fighters into the Fergana Valley, presenting a common problem to the three countries whose territory was involved. China played a catalytic role in bringing the Central Asian countries together. In 1997-8 China had been an economic anchor in East Asia and had sought closer relations with the USA, but it gradually came to resent a perceived asymmetry in this rapprochement, which brought little gain to China. After the US bombing of the Chinese embassy in Belgrade in spring 1999, China pursued a more anti-US course, embracing Japanese proposals for Asian monetary cooperation (which were opposed by the USA) and promoting the SCO as a more formal successor to the Shanghai Forum. Although Russia saw the SCO as a vehicle for its leadership in Central Asia, for the Central Asian leaders, especially Uzbekistan, the SCO was palatable because of China's counterweight. Nevertheless, the regional faultline persisted as Kazakhstan, the Kyrgyz Republic and Tajikistan participated in the Russian-led Collective Security Treaty and Uzbekistan did not.

The SCO is the only international group formed by China, and it receives extensive press coverage in China. Russia was also enthusiastic in the early years of

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<sup>38</sup> At the 2004 SCO summit Mongolia was admitted as an observer.

the Shanghai Five, hoping the grouping would help Russia to retain leverage over Central Asia, but Kazakhstan, the Kyrgyz Republic and Tajikistan all reached border delimitation agreements with China in the late 1990s without consulting Russia. From 1998 to 2001 the organization evolved into a Sino-Russian vehicle for opposing US hegemony and for mutual tolerance of anti-separatist measures in Chechnya and Xinjiang. The military side remains important and joint operations planning in 2001 represented the first cooperation between the Russian and Chinese military since the early 1960s. Russia and China are united in their support for the 1972 Anti-Ballistic Missile Treaty and opposed to US plans to revise the ABM Treaty. The final statement at the 2001 SCO summit called the ABM Treaty “a cornerstone of stability, peace and nuclear deterrence”, and cooperation against terrorism was a major theme.<sup>39</sup> The SCO, however, failed to respond to the September 9<sup>th</sup> assassination of Ahmad Shah Massoud or the September 11<sup>th</sup> terrorist acts in the USA. Chiefs of national border guard services met in Almaty on 24<sup>th</sup>. April 2002 to coordinate responses to terrorism, the drug trade and illegal migration, but there are doubts about the sincerity of such meetings when the Russian military and influential Central Asians are believed to be participating in the drug trade. Earlier in 2002 Chinese Foreign Ministry official Zhou Li called for a coordinated response against “the three forces” (ie. radical Chechen, Uighur and Uzbek organizations),<sup>40</sup> but it seems unlikely that China would welcome foreign troops in Xinjiang.

After the June 2004 SCO summit, Uzbekistan and Russia signed a strategic partnership agreement and China announced plans to extend \$500 million in loans and credits to Central Asian countries. These signs of greater engagement between the Central Asian countries and their two large neighbours do not, however, signal a strengthening of the SCO as a regional organization. Uzbekistan was reacting to a specific stimulus, the reduction of US assistance due to its human rights record. Uzbekistan responded by showing the USA that it has alternative allies who are less concerned about human rights, but Uzbekistan is far from abandoning the USA for the SCO. On the economic level, the Central Asian countries welcome infrastructure and other investment from both Russia and China, but Russia does not want to see China gaining economic influence in Central Asia.

More fundamentally the Central Asian governments do not share the Sino-Russian agenda of opposing US hegemony. Since September 2001 the governments of the Kyrgyz Republic, Tajikistan and Uzbekistan have been willing to cooperate with the USA, providing bases and so forth, rather than coordinating anti-terrorist action under the aegis of the SCO. After the 2001 summit at which Uzbekistan became a member, President Karimov in a speech on Uzbekistan TV stated that “This organization must never turn into a military political bloc . . . It should not be against any country”. Splits among the Central Asian leaders are also evident. A Tajik official was reported in Russia as saying that “None of us is apt to welcome the Uzbek

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<sup>39</sup> At the June 2001 SCO summit it was decided to establish an anti-terrorist centre in Bishkek. However, in May 2001 the CIS Collective Security Treaty signatories had already created a rapid-reaction force with some 2,000 soldiers from Russia, Kazakhstan, the Kyrgyz Republic and Tajikistan committed to fighting potential insurgencies in Central Asia, and the CST would appear to be aimed at pre-empting Chinese (or Uzbek?) participation in joint anti-terrorist action in the region. It took until December 2002 for SCO experts to meet in Bishkek to discuss the rules and activities, funding and staffing of the anti-terrorist centre, and then in September 2003 it was announced that the Bishkek centre had been cancelled and an anti-terrorist centre would be opened in Tashkent in 2004.

<sup>40</sup> Reported in the *Far Eastern Economic Review*, 17<sup>th</sup> January 2002.

imperialists”.<sup>41</sup> Although relations with China are cordial, potential conflicts could surface if China proceeds with plans to divert water from rivers originating in Xinjiang and flowing into Russia and Kazakhstan.<sup>42</sup> Opinions on the future prospects of the SCO – or whether it has a future – are split.

### (e) Prospects for regionalism

Table 8 summarizes the membership of the regional arrangements described in this section. These arrangements have often been in implicit competition, reflecting differing and mutually exclusive political pacts. The evolving patterns have incorporated concerns for closer or more arms-length relations with Russia and, to a lesser extent, China and internal competition for and suspicion of hegemonic leadership within Central Asia. Such ebbing and flowing of interest in alternative regional permutations has inhibited the institutional development of any regional organization involving the Central Asian countries. Although most regional agreements involving the Central Asian countries have an economic content, at least in their stated goals, their economic impact has been minimal.<sup>43</sup> None has reached a stage of seriously discussing preferential trade policies, and none has posed a threat to multilateralism in the Central Asian countries’ trade policies.

Apart from the political twists and turns there are strong economic reasons why the Central Asian countries will not implement preferential regional trading arrangements. The principal argument is the likelihood of trade diversion. The Central Asian countries are competitive, producing a small range of primary products (cotton, oil and gas, gold and other minerals), rather than complementary. Favouring imports from a neighbour will almost always involve purchasing something at well above the world price. Although the political leaders may not express their concerns in Vinerian terms, there is a strong recognition when agreements come down to implementation that, while a country may want to expand the market for its own sheltered industries, they do not want to give preferential status to their neighbours’ manufactured goods.

Regional agreements will continue to be signed in Central Asia because there are other reasons for regional cooperation besides trade policies. Three reasons of particular significance for Central Asia are water resource management (including the desiccation of the Aral Sea and related energy supply issues), security and trade facilitation. The failure to take any common action on the desiccation of the Aral Sea is symptomatic of the inability of Central Asia’s leaders to cooperate on a pressing regional issue, but also symbolises the ongoing need for cooperation. Security

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<sup>41</sup> The statements by President Karimov and by the Tajik official were both reported in *Eurasia Insight* “Russia has Misgivings about Shanghai Cooperation Organization”, 20<sup>th</sup>. June 2001, posted at <http://www.eurasianet.org>

<sup>42</sup> Horsman (2001, 79-81) discusses China’s position concluding that “China is unwilling to engage in meaningful cooperation or compromise in the pursuit of its water demands”. If Kazakhstan were sufficiently aggravated, it might reinstate its agitation over Chinese nuclear testing at Lop Nor and treatment of Uighurs, two issues on which Kazakhstan (and the Kyrgyz Republic) have since the mid-1990s agreed to exercise restraint.

<sup>43</sup> The main caveat to this generalization is that intra-CIS trade continues to be treated differently; intra-CIS trade tends to be freer than trade with non-CIS countries, and the internal free trade regime is especially true with respect to trade among Eurasian Economic Community members. There have been exceptions when trade barriers have been imposed at internal CIS borders, but some of these measures have been temporary. Having noted this element of hysteresis, however, it can be emphasized that positive steps to make internal free trade mandatory or to harmonize external trade policies have been practically fruitless.

matters have been dominant since 1999, and have entered the international spotlight since September 2001. Trade facilitation, while more mundane, is an area in which progress could be made to reduce foregone opportunities for mutually beneficial trade (due to impediments such as unnecessary delays or bureaucracy at border crossings, and official or unofficial taxes on traders) and also to enable landlocked Central Asian countries to facilitate transit of goods to the wider international market.

#### 4. Conclusions

All five of the Central Asian countries which became independent in late 1991 are economies for which primary product exports, and thus trade relations, are important. Although all declared their intention to participate in the global trading system they have, to varying degrees, pursued trade policies incompatible with WTO rules and have, with the exception of the Kyrgyz Republic, been cautious about accepting the obligations imposed by WTO membership. At the same time they have all signed on to myriad regional agreements which might threaten adherence to the most-favoured nation principle at the heart of the WTO-based system. The failure of the many preferential trading agreements mooted since 1992 should have already clarified that they are not a practical route to realizing greater gains from trade.

The striking feature of the regional arrangements described in section 3 is the general lack of progress in establishing or implementing preferential trade policies.<sup>44</sup> Despite many proposals for regional trading arrangements, in practice the Central Asian countries have in their trade policies clearly chosen the path of policy autonomy combined with non-discriminatory multilateralism. Buying imports from the global least-cost supplier and selling exports in the best market makes considerable economic sense, and is supported by the failure of the many discriminatory trading arrangements in Latin America and Africa during the second half of the twentieth century (Pomfret, 1997/2001). The success of the European Union is a red herring insofar as on the political level the EU has been the vehicle for closer political ties, whereas the Central Asian countries have broken earlier political ties and have no wish to compromise their political autonomy now, and on the economic level the least-cost EU producer's price will generally be little different from the world price.<sup>45</sup>

The positive feature of the Central Asian countries' *de facto* multilateralism is that the region remains well-placed to take advantage of opportunities offered by China's recent WTO accession and Russia's imminent accession. Central Asian countries which are or become WTO members will benefit from a rule-based environment in their trade with all neighbouring economies except Afghanistan, and rules which are generally the most desirable for small open economies. The costs in terms of restrictions on import-substitution strategies and other anti-liberal trade policies and in terms of reduced potential for political grandstanding via economic proposals in regional fora are minor – and indeed the tying of governments' hands in

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<sup>44</sup> Comments like “The heads of the CIS states have all met regularly, but the agreements drawn up at their meetings have had no real force” and “most of the employees of the CIS, who at one point numbered about 2,500, were essentially wasting their time” (Olcott, Aslund and Garnett, 1999, 3 and 10) apply to all the organizations listed in Table 8.

<sup>45</sup> There are exceptions to this, eg. in agriculture and in clothing, but the EU appears willing to accept the trade diversion in these sectors. Even allowing for such exceptions, the potential trade diversion associated with potential preferential trading arrangements among the Central Asian economies is much higher due to their similar economic structures and generally uncompetitive manufacturing sectors.

such activities should benefit the countries' citizens. Additional benefits from WTO membership include a possible reform-reinforcing effect, as well as access to the WTO dispute resolution mechanism and the ability to join coalitions working towards reducing trade barriers facing important exports.

Yet, there are benefits from regional cooperation in Central Asia, and if these could be realized that would help to defuse political tensions. In water resource management the potential benefits are obvious and enormous. In preventing terrorism the benefits from regional cooperation are real but may be being manipulated to restrict liberty. Regional cooperation in trade facilitation and in transit arrangements could reduce the tragedy of the anti-commons, where people promoting self-interested goals are choking off trade that would be mutually beneficial. This tragedy can be mitigated by government actions to discourage or regulate anti-social behaviour by local authorities, customs officials and others under their jurisdiction. The national governments can also benefit by implementing policies to reduce other impediments to trade such as cumbersome visa regulations, poorly developed financial systems, and capricious changes in border crossings, but that requires an appreciation that many of the foregone trade opportunities represent win-win situations.

What are the prospects for improved international economic relations in Central Asia during the first decade of the twenty-first century? At the institutional level, existing regional organizations have been strengthened, at least on paper, as the Union of Five became the Eurasian Community, the Shanghai Forum became the Shanghai Cooperation Organization and the Central Asian Economic Community was succeeded by the Central Asian Cooperation Organization. Whether the implementation ability of the new organizations will exceed that of their predecessors remains uncertain. The events of September 2001 stimulated declarations of concerted action against terrorism, but the immediate consequence was to widen the fissure between the Eurasian Community members and the countries which are more sceptical about Russia's role in the region. Moreover, recent developments within the region, especially increased territorial disputes, are creating a climate which is inimical to cooperation. Whether justified on security grounds or not, new border control measures are unpopular among the local populations who have no history of such restrictions, and as assertions of the new states' territorial rights they augur poorly for inter-state cooperation.

On the specific question of the choice between regionalism and multilateralism in trade relations, the verdict from Central Asia is clear-cut. Regionalism may appear attractive, but on deeper investigation preferential regional trading arrangements are unattractive. Multilateralism formalized by WTO membership may look like an unattractive restriction on policy autonomy, but on deeper investigation is the best framework within which the Central Asian countries can develop their international economic relations.

**Table 1: Total Exports and Imports, 1993-2002** (millions of US dollars).

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
<b>Exports</b>										
Kaz.	1,107	3,227	5,256	5,926	6,497	5,511	5,598	9,138	8,647	9,930
KR	360	339	483	506	609	509	454	502	476	480
Taj	350	492	749	772	803	597	689	784	652	537
Tkm	561	1,163	1,881	1,693	751	594	1,187	2,505	1,132	1,219
Uzb	693	1,991	2,718	2,620	2,896	2,310	1,963	2,135	2,028	1,900
<b>Imports</b>										
Kaz.	1,704	3,285	3,807	4,247	4,302	4,373	3,686	5,052	6,363	6,809
KR	447	316	392	795	709	841	610	554	464	593
Taj	532	547	810	668	750	711	663	675	688	705
Tkm	586	904	1,364	1,313	1,228	1,007	1,478	1,788	1,558	1,432
Uzb	918	2,455	3,030	4,854	4,538	2,931	2,481	2,078	2,303	2,370

Source: Elborgh-Woytek (2003, 4 and 5), based on IMF *Direction of Trade Statistics*.

**Table 2: Share of Exports and Imports with the CIS, 1991-9** (percentages)

	1991		1992		1993		1994		1995	
	X	M	X	M	X	M	X	M	X	M
Kazakhstan	91	86	88	94	84	90	58	61	53	69
Kyrgyz Rep	97	80	94	96	88	91	66	66	66	68
Tajikistan	78	82	80	90	53	62	19	43	34	59
Turkmenistan	95	79	80	85	70	78	77	47	49	55
Uzbekistan	84	82	83	86	74	81	62	54	39	41

  

	1996		1997		1998		1999	
	X	M	X	M	X	M	X	M
Kazakhstan	56	70	46	54	40	47	26	43
Kyrgyz Rep	78	58	53	61	45	52	40	43
Tajikistan	43	57	36	64	34	63	46	78
Turkmenistan	68	30	60	55	26	47	na	na
Uzbekistan	21	32	33	27	25	28	30	26

Source: Islamov (2001, 173).

**Table 3: Average Import Tariff, 2002** (percent).

Kazakhstan	7.9
Kyrgyz Republic	5.2
Tajikistan	8.3
Turkmenistan	0.5
Uzbekistan	19.0

*Source:* IMF data reported in World Bank (2004, Table 3.2).

**Table 4: Status of WTO Accession Negotiations**

	<b>Applied</b>	<b>Working Parties</b>	<b>Member</b>
<b>Kazakhstan</b>	January 1996	6 meetings 1997-2004 <sup>a</sup>	
<b>Kyrgyz Rep.</b>	1993		December 1998
<b>Tajikistan</b>	May 2001	WP not yet met	
<b>Turkmenistan</b>	Not applied		
<b>Uzbekistan</b>	December 1994	1 meeting, July 2002	
<b>China</b>	1986		December 2001
<b>Russian Fed.</b>	June 1993	19 meetings, 1995-2003 <sup>b</sup>	

*Source:* WTO website.

*Notes:* a - Kazakhstan Working Parties met on 19-20 March 1997, 9 October 1997, 9 October 1998, 13 July 2001, 15 July 2003, and 4 March 2004.

b - Russian Working Parties met on 17-19 July 1995, 4-6 December 1995, 30-31 May 1996, 15 October 1996, 15 April 1997, 9-10 December 1997, 29-30 July 1998, 16-17 December 1998, 25-26 May 2000, 5 December 2000, 26-27 January 2001, 26-27 June 2001, 23-24 January 2002, 25 April 2002, 20 June 2002, 31 January, 6 March, 10 April and 10 July 2003.



**Table 5: Trade between Central Asia and China** (in million US dollars)

## (a) Chinese Trade Statistics

	1997		1998		1999		2000		2001	
	M	X	M	X	M	X	M	X	M	X
<b>Kaz</b>	95	433	205	431	494	644	599	958	328	961
<b>KR</b>	71	36	172	26	103	32	110	67	77	42
<b>Taj</b>	11	9	11	8	2	6	7	10	5	5
<b>Tkm</b>	12	3	10	2	7	2	12	4	31	1
<b>Uzb</b>	62	140	58	32	27	13	39	12	51	8

## (b) Central Asian Trade Statistics

	1997		1998		1999		2000		2001	
	M	X	M	X	M	X	M	X	M	X
<b>Kaz</b>	47	442	51	382	82	473	154	670	169	656
<b>KR</b>	32	32	44	16	37	25	37	44	49	19
<b>Taj</b>	2	13	1	5	3	3	12	3	0	0
<b>Tkm</b>	7	2	6	6	14	5	16	8	35*	1*
<b>Uzb*</b>	68	127	64	29	30	12	43	11	56	7

Source: IMF *Direction of Trade Statistics*

Notes: In both tables X = Central Asian exports to China, M = Central Asian imports from China. For Uzbekistan, all years, and Turkmenistan 2001 the data marked \* are constructed from partner country records.

**Table 6: Stock of Foreign Direct Investment in 2002** (millions of US dollars)

Kazakhstan	15,354
Kyrgyz Republic	415
Tajikistan	162
Turkmenistan	1,163
Uzbekistan	1,332

Source: UNCTAD *World Investment Report* (United Nations, New York and Geneva, 2003)

**Table 7: Trade between Central Asia and Russia** (in million US dollars)

## (a) Russian Trade Statistics

	1997		1998		1999		2000		2001	
	M	X	M	X	M	X	M	X	M	X
<b>Kaz</b>	2472	2743	1881	1877	1222	1391	2246	2197	2544	1834
<b>KR</b>	167	149	131	129	84	95	103	88	83	61
<b>Taj</b>	90	97	77	59	66	111	56	237	69	129
<b>Tkm</b>	265	156	94	43	60	77	130	473	139	39
<b>Uzb</b>	875	1016	485	521	240	466	274	662	364	580

## (b) Central Asian Trade Statistics

	1997		1998		1999		2000		2001	
	M	X	M	X	M	X	M	X	M	X
<b>Kaz</b>	1969	2288	1712	1611	1351	1139	2460	1784	2891	1748
<b>KR</b>	191	99	204	84	109	71	133	65	85	65
<b>Taj</b>	115	63	102	48	92	115	105	259	129	105
<b>Tkm</b>	164	57	132	29	167	44	255	1029	153*	35*
<b>Uzb*</b>	962	923	533	474	264	423	302	602	400	527

Source: IMF *Direction of Trade Statistics*

Notes: In both tables X = Central Asian exports to Russia, M = Central Asian imports from Russia. For Uzbekistan, all years, and Turkmenistan 2001 the data marked \* are constructed from partner country records.

**Table 8: Membership of Regional Agreements involving Central Asian Countries**

	CIS	Eurasian Com.	UES	CACO	SPECA	ECO	SCO
Kazakhstan	x	x	x	x	x	x	x
Kyrgyz Rep	x	x		x	x	x	x
Tajikistan	x	x		x	x	x	x
Turkmenistan	x				x	x	
Uzbekistan	x			x	x	x	x
Russia	x	x	x				x
China							x
Iran						x	
Pakistan						x	
Turkey						x	
Afghanistan						x	
Azerbaijan	x					x	
Armenia	x						
Belarus	x	x	x				
Georgia	x						
Moldova	x						
Ukraine	x		x				

*Note:* see text for details.

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