TRADE TAXES IN CAREC COUNTRIES[1]

Background Paper for the CAREC TPCC Meeting[2]

I. Introduction[3]

Trade taxes are an important trade policy instrument. They directly affect the price of traded goods and indirectly influence trade volumes and thus are important for the design of macroeconomic policies. In addition, changes in tariff measures might affect public finances as taxes on international trade may be an important source of government revenue.

The paper analyzes the taxes levied on international trade in CAREC countries. The objective is to understand the nature and the scope of trade taxes in CAREC countries and assess to what extent they could be a barrier to trade. However, understanding overall trade developments in CAREC countries is not possible without examining non-tariff barriers and other policies affecting trade, which are outside the scope of this paper.

In Section II the paper provides some background information on recent trends in trade and looks at the system of import and export taxes in CAREC countries. Based on this analysis, Section III summarizes the main issues related to trade taxes. Section IV provides an assessment of the importance of trade taxes for public finances and outlines the strategies to reform the existing tariff schedules and to offset possible losses from lower trade taxes. The paper concludes with policy recommendations based on best international practices.

II. Description of trade taxes in CAREC countries

1. Recent trade developments in CAREC countries

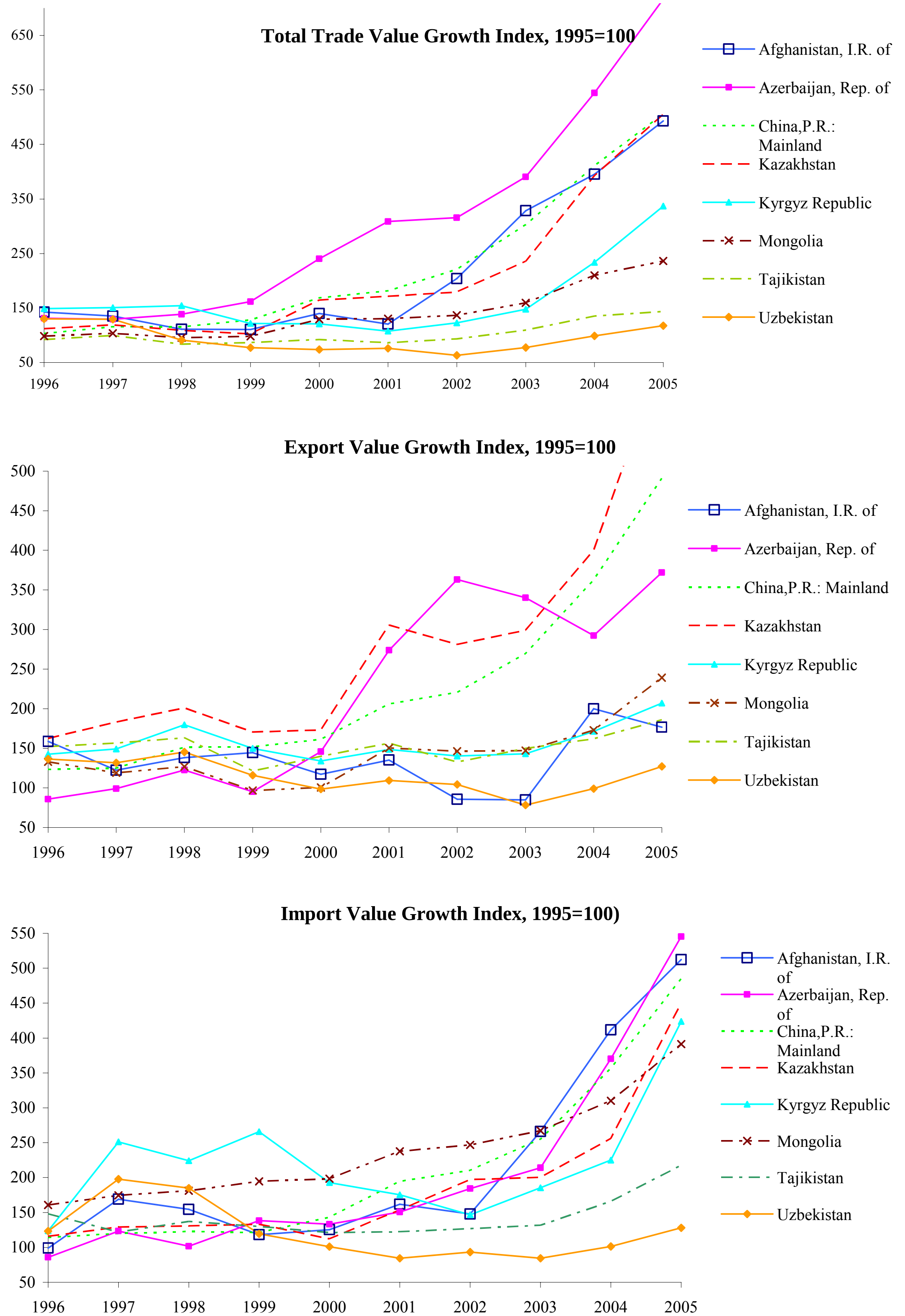
The transition to a market system was critical for enhancing trade flows in most CAREC countries. Trade reforms began in most CAREC countries in the early 1990s. In Azerbaijan, Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan reforms followed the breakup of the Soviet economic system. The initial years of the transition saw little or no trade growth as many trade links collapsed along with production chains, payment systems, and transportation networks (Figure 1).When the transition finally took off and economic relations became largely market-based, trade growth resumed. In Azerbaijan, Kazakhstan, and Mongolia trade growth has accelerated since 1999. In the Kyrgyz Republic, Tajikistan, and Uzbekistan, trade picked up in 2001–02. In China, trade reforms followed after a speeding up of market-oriented reforms in the last ten years. The stabilization of the

[1] The Central Asia Regional Economic Cooperation (CAREC) program includes Afghanistan, Azerbaijan, the People's Republic of China, the Republic of Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan.

[2] Presented by Veronica Bacalu at the September 2006 TPCC meeting.

[3] The views expressed in this paper are those of the author and should not be attributed to the International Monetary Fund, its Executive Board, or its management.

Figure 1. Trade developments in CAREC Countries, 1996-2005

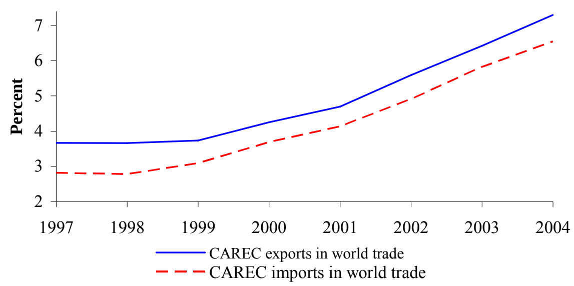


Source: COMTRADE

political situation in Afghanistan enabled the launch of trade-related reforms in this country over the past five years. In many CAREC countries, trade liberalization was conducted under IMF-supported programs and consultations. At the same time, trade-related issues have been discussed and negotiated with the World Trade Organization (WTO). Currently, China, the Kyrgyz Republic, and Mongolia are members of the WTO while Afghanistan, Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan have observer status.

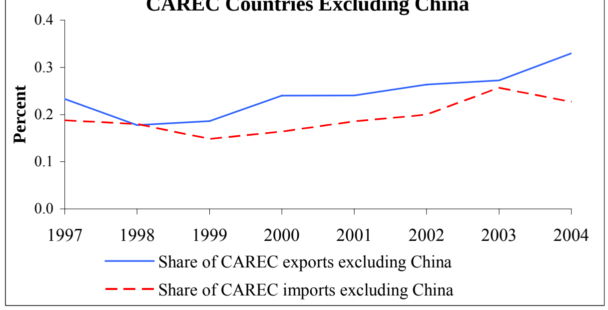
The share of CAREC countries' trade in total world trade has steadily increased over the last decade (Figure 2). However, this increase was mainly the result of China's trade, which as a share of world trade more than doubled in the past decade and reached over 6 percent. At the same time, the rest of the CAREC countries' share in total world trade increased only marginally (Figure 3). Interestingly, as a share of total world trade, exports grew somewhat faster than imports in CAREC countries (excluding China). This can be explained by increased energy exports in some of these countries.

Figure 2. Share in World Trade, 1997-2004[1/], All CAREC Countries



Source: COMTRADE
1/ No data for Afganistan.

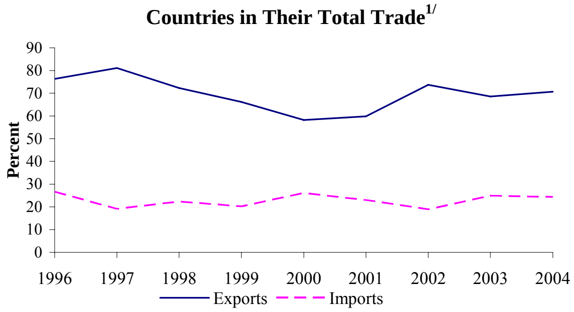
Figure 3. Share in World Trade, 1997-2004[1/], CAREC Countries Excluding China



Source: COMTRADE
1/ No data for Afganistan.

The share of intraregional trade in total trade varies significantly among CAREC countries (Figures 4 and 5). If China and Afghanistan are excluded, trade links are strong between the remaining six countries with about a quarter of imports and three quarters of exports being intraregional. However, including China, less than one percent of all CAREC trade is intraregional. It should be noted, however, that trade with China has been increasing in recent years.

Figure 4. Share of Trade between Six CAREC Countries in Their Total Trade[1/]



Source: COMTRADE
1/ Excluding China and Afganistan. Data not available for the latter.

Figure 5. Share of Trade among CAREC Countries in their Total Trade[1/]

Source: COMTRADE
1/ No data for Afganistan.

2. Import taxes in CAREC countries

The rationale for and the impact of trade taxes

Governments have different arguments in favor of various tariff or other tax measures to control imports. The rationale behind levying them includes the need to (i) protect some domestic sectors; (ii) raise additional revenue; (iii) reduce imports due to balance of payments problems; and (iv) use tariffs as a bargaining tool in negotiations with trading partners.

However, import tariffs and other import protection measures have significant negative effects on the economy. Economic theory and empirical studies suggest that import protection works as any government intervention in the price setting process─it distorts resource allocation and consumption decisions and is therefore generally welfare reducing.[4] Tariffs raise the domestic price of imported goods and shelter domestic producers from international competition. Thus, import-substitution industries are helped while exporters and producers of nontradables are hindered. Therefore, protectionism affects the distribution of income as it always benefits some firms or sectors at the expense of the rest of society. Governments usually overestimate their ability to choose the right industry to protect and, over time, are heavily influenced by special-interest politics rather than a consideration of national costs and benefits.[5] Furthermore, some research studies look at different aspects of the so-called "Lerner symmetry" and prove that imposing taxes on imports is similar to taxing the country's exports (Box 1).

Description of import taxes in CAREC countries[6]

Assessing the level of import tariff protection is further complicated by the complex tariff system in place in some CAREC countries.[7] Many CAREC countries have shifted their tariffs to the ad valorem methodology under the WTO Harmonized System of classification

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[4] See Baldwin (1969) and Corden (1974).

[5] See Krueger (1974) and Bhagwati (1982).

[6] For WTO terminology please see Box 2.

[7] Our analysis of external trade taxation in CAREC countries is limited by the availability of comparable data and time series. Tariff and trade data available from different sources (authorities reports, WTO, UNCTAD, COMTRADE, WB, IMF databases) are in some cases incomplete, as they do not consistently include specific and mixed-duty tariffs, and data series are not fully available across countries. In addition to tariffs, estimates of other taxes and duties are not available for all countries. Sometimes it is not clear whether preferential rates (namely exemptions originating from countries' participation in preferential trade agreements) are included in calculations. Data for some years are available for mid-year instead of end-year. Also, some discrepancies exist as calculations for different countries are made for tariff lines at different digit levels of the Harmonized System. Therefore, some caution should be exercised when analyzing data available on trade taxes.

Box 1. Does Import Protection Discourage Exports?[1/]

Tokarick (2006) argues that many developing countries seek to increase their export earnings, but they have not embraced fully the notion that their own pattern of import protection hurts their export performance. In his paper, he quantifies the extent to which import protection acts as a tax on a country's exports and finds that the export-tax equivalent of import tariffs is quite large for some developing countries (about 12½ percent on average for 26 developing countries, while 7 countries had an export-tax equivalent in excess of 16 percent and 4 had an export-tax equivalent in excess of 25 percent). The author states that the anti-export bias from import tariffs arises for at least three reasons:

- import tariffs lower the domestic relative price of exports. A tax levied on imports raises the domestic price of imports relative to exports, or equivalently, reduces the price of exports relative to imports.[2/] Also, as tariffs raise the price of imports, consumption shifts to home goods, increasing their price. The increase in the price of nontraded goods relative to that of exports reduces the incentives to export;

- they alter wages and rental rates which must be absorbed by the export sector; and

- they raise the cost of imported intermediate inputs used by export sectors.

The author concludes that "it is not possible for a country to simultaneously protect their import-competing sectors and promote their export sectors—these policies work at cross purposes to each other."

1/ Tokarick, Stephen, 2006, "Does Import Protection Discourage Exports?" IMF Working Paper 06/20, (Washington: International Monetary Fund).

2/ See Lerner (1936). The Lerner symmetry theorem states that, based on an assumption of a zero balance of trade (that is, the value of exported goods equals the value of imported goods for a given country), an ad valorem import tariff (a percentage of value or an amount per unit) will have the same effects as an export tax. The theorem is based on the observation that the effect on relative prices is the same regardless of which policy (ad valorem tariffs or export taxes) is applied.

of traded goods. At the same time, specific, combined, and mixed tariffs are still widespread in some CAREC countries. Azerbaijan, Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, and Uzbekistan apply specific tariffs expressed in EUR, U.S. dollars, or national currency to a volume of some imports expressed in a specific unit (liter, ton, units, etc). Some countries (e.g., Kazakhstan and Uzbekistan) use compound tariffs for some goods applying specific tariffs simultaneously with ad valorem tariffs. Therefore, assessing the overall level of tariffs is complicated by the need to convert these specific and combined tariffs to ad valorem for comparability.

Box 2. Main Definitions Used in the Analysis of Trade Taxes

Harmonized System. An international nomenclature developed by the World Customs Organization, which is arranged in six-digit codes allowing all participating countries to classify traded goods on a common basis. Beyond the six-digit level, countries are free to introduce national distinctions for tariffs and many other purposes.

Tariffs. Customs duties on merchandise imports levied either on an ad valorem basis (percentage of value) or on a specific basis (e.g., $7 on each 100 kilograms). Tariffs give price advantages to similar locally produced goods and raise revenues for the government.

Ad-valorem tariff. An import duty with a tariff rate charged as a percentage of the price.

Specific tariff. An import duty with a tariff rate charged as a fixed amount per quantity such as $100 a ton.

Compound tariff. A combination of ad valorem and specific tariffs (e.g., 10 percent plus $5 a kilogram).

Mixed tariffs. A choice between ad valorem and/or specific tariffs depending on the condition attached (e.g., 10 percent or $5 a kilogram, whichever is greater).

Tariff binding. Commitment not to increase a rate of duty beyond an agreed level. Once a rate of duty is bound, it may not be raised without compensating the affected parties.

Tariff peaks. Relatively high tariffs, usually on "sensitive" products. Tariffs of 15 percent and above are generally recognized as international tariff peaks. Tariffs at least three times higher than the member's overall simple average are recognized as domestic peaks.

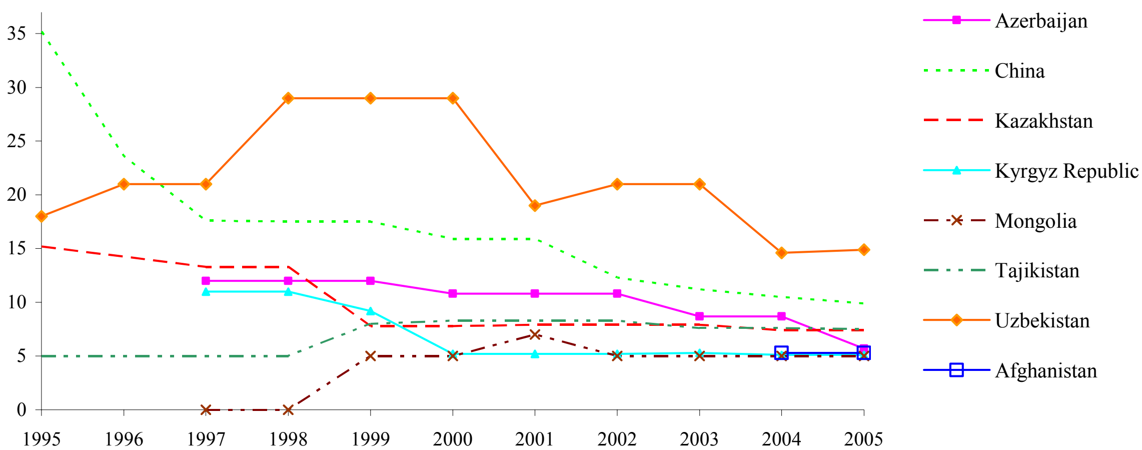
Duty drawback. Providing rebates to exporters for the tariff duties paid on imported intermediate inputs.

Most-favored-nation (MFN). Most-favored-nation treatment (GATT Article I, GATS Article II, and TRIPS Article 4), the principle of not discriminating between one's trading partners.

Source: WTO, WTO | Glossary - a guide to 'WTO speak'

The overall level of tariffs declined in most CAREC countries over the past decade (Figure 6)**.**[8] As a result, the unweighted average tariff for CAREC countries as a group declined from 11.4 percent in 1997 to 7.6 percent in 2005. The most significant and steady decline in the unweighted average tariff rate was registered in China. At the same time, tariffs increased slightly in Mongolia and Tajikistan from earlier very low levels.

Figure 6. Trends in Average Tariff Rates in CAREC Countries[1/]



Source: IMF TPIDB
1/ Simple unweighted average import tariffs including other duties and charges on imports, percent.

The most recent data indicate that tariff regimes are no longer restrictive in most CAREC countries (Table 1). Tariff restrictiveness measured by the simple unweighted average import tariff varies from relatively open to open compared to a decade ago when some CAREC countries fit more restrictive categories. According to the most recent available data, the simple unweighted average tariff in CAREC countries ranges from 3.9 percent in Afghanistan to 14.8 percent in Uzbekistan. Tariffs are fairly low in the lower single digits in the Kyrgyz Republic, Mongolia, and Azerbaijan and are somewhat higher in the single digit range in China, Kazakhstan, and Tajikistan.

Table 1. Tariff Restrictiveness Classification in CAREC Countries[1/]

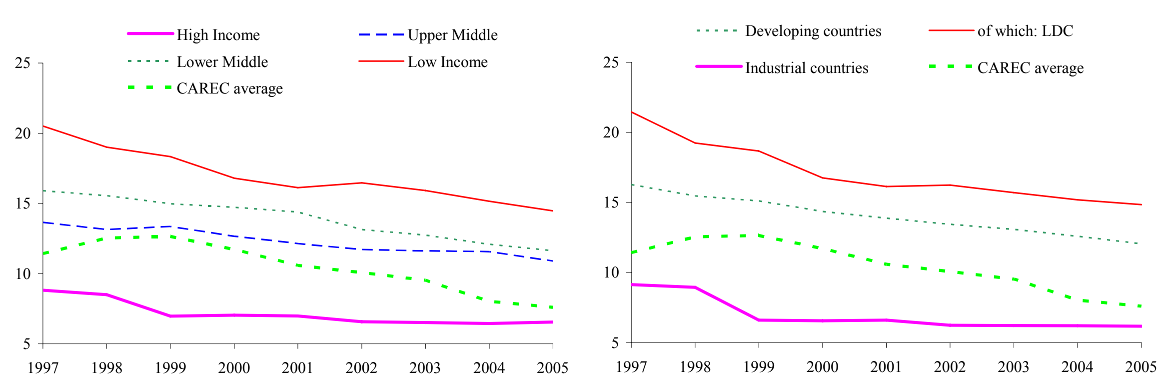
Classification	Average Tariff Range (t percent)	CAREC Countries Classification in 2005	CAREC Countries Classification in 1995[2/]
Open	0 < t < 10	Afghanistan (3.9), Azerbaijan (5.7), China (9.8), Kazakhstan (7.4), Kyrgyz Republic (5.0), Mongolia (4.5), Tajikistan (7.5)	Mongolia (8.2), Tajikistan (5),
Relatively Open	10 < t < 15	Uzbekistan (14.8)	Kyrgyz Republic (10), Azerbaijan (12)
Moderate	15 < t < 20		Kazakhstan (15.2), Uzbekistan (18)
Relatively Restrictive	20 < t < 25		
Restrictive	> 25		China (35.2)

Source: Sharer and others (1998), UNCTAD TRAINS; authorities' data.
1/ Simple unweighted average tariffs in percent.
2/ No data for Afghanistan in 1995. Data as of 1997 for Kyrgyz Republic .

[8] The analysis of the tariff level includes specific and combined tariffs converted to ad valorem rates where applicable. However, consistency over countries is not ensured.

The average import tariff in CAREC countries as a group is relatively low compared with average tariffs in other similar countries (Figure 7). It is lower than the average tariff in low and middle income developing countries, but higher than that in high income countries. The trend decline in the average tariff in CAREC countries was broadly in line with the trend decline worldwide. Thus, on average, the import tariff does not provide for a high level of protection in CAREC countries, although there are significant variations among countries.

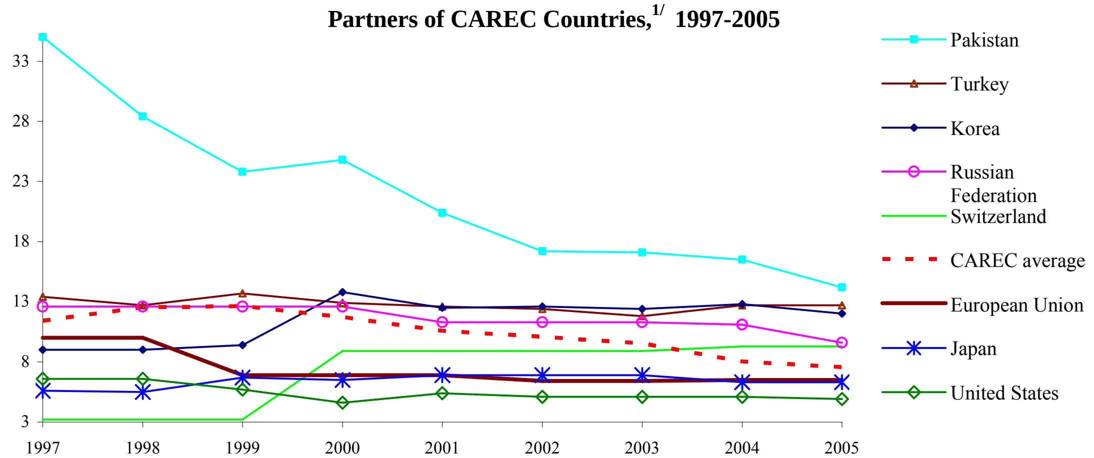
Figure 7. Trends in Average Import Tariffs in Countries with Different Income Levels[1/]



Source: IMF TPIDB
1/ Simple unweighted average import tariffs including other duties and charges on imports, percent. For country classifications see www.worldbank.org.

The unweighted average import tariff in CAREC countries is also low compared with those of many of their trading partners (Figure 8). It is lower than in Korea, Pakistan, Russia, Switzerland, and Turkey, but higher than the average tariffs in the European Union, Japan, and the United States.

Figure 8. Trends in Average Tariff Rates in Main Trading Partners of CAREC Countries,[1/] **1997-2005**



Source: IMF TPIDB
1/ Simple unweighted average import tariffs including other duties and charges on imports, percent. Trading partners with shares of exports or imports exceeding 10 percent of total.

The import-weighted average tariff also confirms the relatively low level of import protection from tariffs in most CAREC countries (Table 2). It is broadly in line with the simple average tariff in many of them and varies from 4.3 percent in the Kyrgyz Republic and Mongolia to 16.6 percent in Uzbekistan. However, the weighted average tariff is higher than the simple average in some CAREC countries pointing to a higher share of imports with higher tariffs. Thus, more goods are imported at higher rates in Afghanistan, Azerbaijan, Kazakhstan, Tajikistan, and Uzbekistan.

Tariff dispersion is on average moderate in CAREC countries, but varies from case to case (Table 2). The number of tariff bands is small in most CAREC countries reaching ten in the Kyrgyz Republic and Kazakhstan. Maximum tariff rates vary from 15 percent in

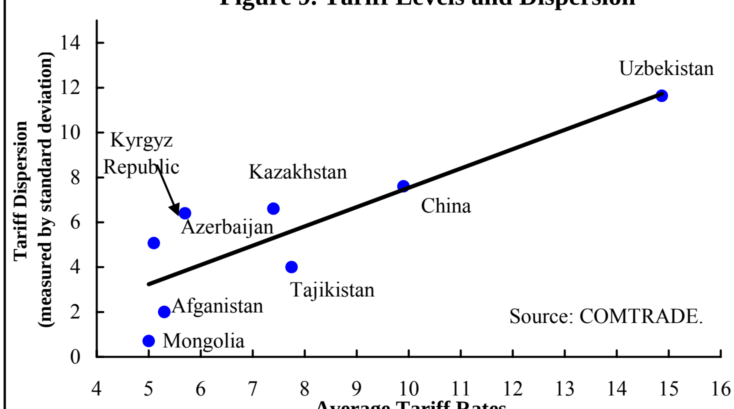
Table 2. Measures of Tariff Dispersion in CAREC countries in 2005

Country name	Simple average rate 1/	Simple average rate including other duties and charges 1/	Weighted average rate 1/ 2/	Standard deviation 2/	Minimum rate 1/	Maximum rate 1/	Number of tariff bands	Number of domestic peaks	Number of international peaks
Afghanistan	3.9	5.3	9.7	2.0	0	16	6	...	...
Azerbaijan	5.7	...	7.8	6.4	0	15	6	...	...
China	9.8	9.9	5.3	7.1	0	65	...	106	2417
Kazakhstan	7.4	...	13.9	6.6	0	30	10	371	2169
Kyrgyz Republic	5.0	5.1	4.3	5.1	0	30	10	2	2
Mongolia	4.5	5.0	4.3	0.7	0	15	3	6	0
Tajikistan	7.5	...	7.8	4.0	0	15	4	87	1072
Uzbekistan	14.8	...	16.6	11.6	0	30	4	5	1512

Source: WTO database, IMF TPIDB, authorities' data.
1/ In percent.
2/ For the latest year available.

Azerbaijan, Mongolia, and Tajikistan to 65 percent in China.[9] The number of domestic peaks[10] is low in most countries, but the number of international peaks[11] is considerable in some of them, indicating that many tariffs are higher than 15 percent. The tariff dispersion as measured by the standard deviation varies among countries and has a positive correlation with average tariff rates (Figure 9).

Figure 9. Tariff Levels and Dispersion



[9] A couple of years ago, however, maximum tariffs applied to some industrial goods reached 100 percent in Kazakhstan and Uzbekistan, 120 percent in China, and 150 percent in Afghanistan.

[10] Tariffs at least three times higher than the member's overall simple average tariff.

[11] Tariffs of 15 percent and above.

In other words, higher tariff rates are generally associated with higher discriminatory tariff structures.

The collected trade taxes as a share of imported goods are low in CAREC countries. The collected rates are considerably lower than the average simple tariff rates in Azerbaijan, China, Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan (Table 3) reflecting the high levels of exemptions, preferential tariffs, and evasion. The collected rate is higher than the simple average rate in Afghanistan because of the existence of many other external trade taxes besides import tariffs. In Mongolia, the two rates are equal, which can be explained by the fact that Mongolia has been reforming its trade regime and implementing its WTO obligations since its accession in 1997.

Table 3. Average Tariff Rate Versus the Collected Rate in 2005 (percent)

	Simple unweighted average tariff rate	Collected trade taxes, share of imports
Afghanistan	3.9	4.5
Azerbaijan	5.7	2.4
China	9.8	4.4 [1/]
Kazakhstan	7.4	2.6
Kyrgyz Republic	5.0	1.2
Mongolia	4.5	4.5
Tajikistan	7.5	2.3
Uzbekistan	14.8	3.0

Source: Authorities, WTO database.
1/ Data as of 2001.

A number of direct and indirect import taxes are levied in many CAREC countries in addition to import tariffs. Customs fees are levied on imports in many CAREC countries. These are small varying from 0.2 percent in Uzbekistan to 0.15 percent in Azerbaijan, the Kyrgyz Republic, Mongolia, and Tajikistan. In addition, special taxes are applied to imports in some countries, depending on the country of origin of imported goods. For example, Uzbekistan applies a 20 percent customs fee on imports of non-food goods produced in third countries and re-exported from neighboring countries. There is also an implicit tax on imports in several CAREC countries originating from the differentiated application of VAT and excise taxes to imported and domestically produced goods. Azerbaijan, Kazakhstan, Mongolia, and Uzbekistan apply higher excise rates to a number of imported goods compared with similar domestically produced goods. Non-uniform VAT and excise rates are also applied to goods produced in special economic zones in China. It should be noted, however, that an implicit negative import tariff appears in some instances in Azerbaijan and Uzbekistan when some imported goods are exempted from VAT, while domestic goods are subject to it.

Tariffs that vary depending on the importer and the timing of imports also complicate the system in some CAREC countries. The application of import tariffs is not always uniform across all types of importers. In particular, some countries apply different schedules to some groups of importers irrespective of the type of imported goods. For example, Afghanistan levies a 2 percent charge on imports by small businesses creditable against income tax, and 3 percent on imports by an importer without a business license. Imports by individual entrepreneurs in Uzbekistan are subject to a unified tax on imports which varies from 26 percent on wheat flour to 40 percent for other foods and 70 percent for non-food goods. These taxes are, however, substitutes for tariffs and the value-added tax. Finally, there are instances when import tariff rates vary within a specific year. For example, Mongolia imposes a seasonal import duty rate of 15 percent on flour and some vegetables between August 1 and April 1 to protect domestic producers. Outside this period, the applied tariff rate for the above agricultural goods is 5 percent. Similarly, the Kyrgyz Republic imposes a 30 percent seasonal tariff on refined sugar.

The share of duty free imports is high in all CAREC countries (Table 4), reaching 70–80 percent of imported goods in some of them. The main reasons for such a high share of duty-free imports are the following:

Table 4. Share of Duty Free Imports in CAREC Countries, (percent of total imports[1/])

Afghanistan	60-70
Azerbaijan	60
China	30
Kazakhstan	25
Kyrgyz Republic	50
Mongolia	30
Tajikistan	80
Uzbekistan	56

Source: Authorities, WTO database.
1/ Estimates, including zero tariff imports, preferential agreements, and exemptions to published rates.

- participation in regional trade agreements. The Central Asian countries are part of the CIS free trade agreement. In addition, Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan are members of the Eurasian Economic Community (EAEC). Many goods under the EAEC agreement are placed under preferential treatment and are zero-taxed;

- application of exemptions to published tariffs. Some of them are one-time ad hoc executive decisions, while other regulations exempt goods under certain government agreements, loans, and projects; and

- unilateral application of preferential zero-rated tariffs to trade with the least developed countries.

Duty drawback provisions

Duty drawback schemes and rebates on tariffs and other taxes on imported inputs are not widely used in CAREC countries. The following are examples of refund schemes in CAREC countries.

- A drawback of import duties and taxes may be claimed where the imported goods are processed in Kazakhstan and exported within two years after importation. The processing operations that qualify for drawback include manufacturing and assembly operations and repairs. Imported goods such as catalysts or lubricants, which are used in the production of other exported goods, are eligible for a drawback.

- China refunds exporters those tariffs which were paid on imported inputs despite the fact that they qualified for tariff exemptions.

- Mongolia tentatively introduced a system of rebates on taxes paid on imported inputs used for exports in 2003.

2. Export taxes

Export taxes are levied by some CAREC countries. The rationale behind taxing exports is broadly to: (i) raise revenues in case of the exploitation of natural resources; (ii) support domestic industry by ensuring lower prices on raw material inputs; (iii) substitute for income tax; and (iv) compensate for the costs of customs procedures.

In general, export duties do not play a significant role in the tax structure of most CAREC countries. They are usually in the form of customs fees and are low. Several CAREC countries, however, levy some other taxes on exports, albeit on a small scale and, sometimes, as part of a more complicated domestic taxation scheme. For example, Mongolia applies export taxes on a list of commodities, including raw wool, scrap metal, and wood varying from Tog100 on each kilogram of camel wool to Tog1,500 on each kilogram of copper waste and scrap, and to Tog4,000 on each kilogram of raw cashmere. Azerbaijan taxes oil exports by domestic oil companies and levies taxes on exports of some metals, including scrap. China applies specific and ad valorem export duties to some textiles, clothing goods, metals, and benzene. Tajikistan applies a 10 percent sales tax on cotton and a 3 percent sales tax on alumina which are levied on exports of these commodities as well. Afghanistan currently applies a 2 percent charge on exports of small businesses, creditable against income tax. In addition, in Afghanistan, a cascading turnover tax varying from 2 percent to 5 percent and 10 percent is levied on limited companies and is also applied on exports of these companies.

III. Main issues related to trade taxes in CAREC countries

Trade taxes are very complex and difficult to enforce in some CAREC countries. In particular, specific and compound tariffs are not transparent and are difficult to implement even with a relatively moderate number of tariff bands. Multiple rates induce misclassification and evasion. Non-uniform application of different taxes, including tariffs, to different groups of importers and exporters is costly and diminishes the efficiency of the regime. Finally, the existence of other taxes on imports and exports complicates the tax regime and hinders trade.

Trade regimes change frequently and are not predictable in many CAREC countries. In a number of countries tariff measures and taxes are approved annually or sometimes even more frequently. In addition, some countries' practices allow ad hoc decrees and resolutions on trade regulations, in particular on exemptions. Numerous and ad hoc exemptions create incentives for lobbying for new exemptions. To the contrary, orderly changes to their trade regimes are made by the countries that are WTO members (China, the Kyrgyz Republic, and Mongolia) as these changes are specified in their accession agreements. They have bound 100 or close to 100 percent of their tariff schedules, thus making their regimes transparent and predictable.

Participation in several regional trade agreements makes trade systems more complex and sometimes complicates ongoing trade liberalization.[12] The existing trade agreements may imply more discrimination in tariff rates when imports from some partners are granted tariffs below those from other partners. This may result in a shift to more expensive imports from preferential regional suppliers. In addition, the existence of preferential trade agreements sometimes encourages misreporting of the imported goods' country of origin in order to benefit from lower or no import duties. In the case of the EAEC, the envisaged

[12] See Tumbarello (2005) and http://www.adb.org/Carec/documents/summary.pdf

common external tariff may not be compatible with the current tariff structures of member countries, who have relatively more open trading systems.

Customs and tax administration is weak in many CAREC countries. Customs administrations are relatively young in most countries with weak institutional capacity and poor governance. Moreover, lack of modern border infrastructure and equipment in a number of countries undermines the operational efficiency of customs administration. In some countries, tax administration similarly lacks effectiveness due to human and physical capacity constraints. In addition, the difficult business environment in some countries encourages red tape and corruption, and the frequent changes in customs and tax legislation make laws difficult to enforce.

IV. Dealing with the Revenue Effects of Trade Reform

Trade taxes contribute a relatively low percentage of revenue in many CAREC countries (Table 5). The reliance on trade tax revenues varied somewhat over the past decade but remained relatively low in most countries with the exception of Afghanistan.

Table 5. Share of Taxes on International Trade in General Government Revenue (in percent) [1/]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Afghanistan, I.R. of [2/]	...	...	...	...	...	...	...	...	45.1	56.6	50.2
Azerbaijan, Rep. of [2/]	3.7	4.7	7.7	8.4	9.0	6.4	5.3	3.4	3.1	3.3	3.2
China,P.R.: Mainland	8.8	8.1	7.4	6.3	9.5	10.7	9.7	...	...	...	...
Kazakhstan	...	...	3.6	3.2	3.3	3.2	3.1	4.6	3.6	3.5	2.9
Kyrgyz Republic	3.7	4.8	4.0	5.1	3.3	2.4	2.1	2.6	2.3	2.1	...
Mongolia	8.6	11.4	5.1	0.8	4.6	7.4	7.5	5.3	6.4	...	6.8
Tajikistan	...	...	...	...	...	9.6	12.5	10.9	9.0	9.1	7.2
Uzbekistan	...	...	...	...	...	1.9	1.9	2.0	2.6	2.4	2.2
Memorandum items:											
Russia	...	3.2	3.0	3.8	5.3	8.5	9.0	7.9	9.4	13.8	18.8
United States	1.4	1.3	1.1	1.1	1.1	1.1	1.0	1.1	1.2	1.2	...

Sources: COMTRADE, World Bank World Development Indicators (2006), and Fund staff calculations
1/ Taxes on international Trade do not include VAT and excises on imports.
2/ Central government.

Trade taxes are also low if measured as a share of GDP in CAREC countries (Table 6**).** Afghanistan, Azerbaijan, Mongolia, and Tajikistan collect from 1½ percent to 2½ percent of GDP in customs duties, while trade taxes in China, Kazakhstan, the Kyrgyz Republic, and Uzbekistan account for less that one percent of GDP.

Table 6. Share of Taxes on International Trade in GDP (in percent) [1/]

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Afghanistan, I.R. of [2/]	...	...	...	...	...	...	...	...	2.0	2.5	2.6
Azerbaijan, Rep. of [2/]	0.6	0.8	1.5	1.7	1.6	1.3	1.0	0.9	0.8	0.9	0.8
China,P.R.: Mainland	0.5	0.4	0.4	0.4	0.6	0.8	0.8	...	...	...	...
Kazakhstan	...	...	0.5	0.6	0.6	0.7	0.8	1.0	0.9	0.9	0.8
Kyrgyz Republic	0.8	0.9	0.8	1.1	0.6	0.4	0.4	0.6	0.5	0.5	...
Mongolia	1.7	2.2	1.1	0.2	1.0	2.2	2.4	2.0	2.4	...	2.5
Tajikistan	...	...	...	1.1	1.3	1.3	1.9	1.8	1.5	1.6	1.4
Uzbekistan						0.7	0.6	0.7	0.9	0.8	0.7
Memorandum items:											
Russia	...	1.1	1.2	1.3	1.8	3.1	3.4	3.0	3.4	5.1	7.5
EU	0.5	0.5	0.3	0.3	0.3	0.2	0.2	0.2	0.2	...	...
United States	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	...

Sources: COMTRADE, World Bank World Development Indicators (2006), and Fund staff calculations
1/ Taxes on international Trade do not include VAT and excises on imports.
2/ Central government.

The impact of a further decline in tariff levels is likely to be manageable in most CAREC countries, given the relatively low contribution of international trade taxes to their revenue. Tariff reforms should not lead to a decline in customs duties as revenues could also be boosted by:

- eliminating exemptions from published tariff schedules;
- enhancing compliance by simplifying tariff schedules, reducing dispersion, and consolidating other fees and charges into a single tax;
- converting non-tariff barriers to tariffs; and
- strengthening customs administration and improving enforcement.

In addition, losses from tariff reductions could be offset by raising trade-neutral domestic consumption taxes, in particular VAT and sales taxes.[13] Thus, reductions in customs tariffs accompanied by reforms in the tariff regime and customs administration are likely to boost budgetary revenues in most CAREC countries.

V. Conclusions and Policy Recommendations

Import tariffs are relatively low in CAREC countries but the trade tax regimes are very complex. The overall level of import tariffs, as measured by simple and weighted average tariff rates, is relatively low. However, the trade tax regimes are complex because tariffs are not levied fully on an ad valorem basis and uniformly across different importers; multiple

[13] See Ebrill, Stotsky, and Gropp (1999).

other taxes in the form of fees and charges are applied to imports; higher excise taxes are imposed on imported goods compared with similar domestically produced goods; and exemptions from import tariffs are widespread. Furthermore, frequent and ad hoc changes in tariff regimes make them unpredictable . These characteristics together with weak customs and tax administrations in some countries create enforcement problems.

Reform of trade taxes in CAREC countries should aim at a simple, transparent regime, with low and relatively uniform rates. Tariffs and other trade taxes should be reduced in countries where the cumulative average rate is high. To maximize their benefits, reforms in all countries should also aim at: reducing the maximum and high tariff rates; cutting the number of tariff bands where applicable; eliminating specific and combined tariffs by shifting to an ad valorem methodology for simpler calculation and enforcement; removing exemptions and abstaining from granting them in the future; applying taxes (VAT and excise) uniformly to imported and domestically produced goods; and consolidating other import taxes and charges into a single rate. Preferably, countries should aim at a simple average tariff below 10 percent, with 2 or 3 non-zero tariff bands and a maximum tariff rate of 20 percent. There could initially be some exceptions to the maximum rate, but these exceptions should be limited in duration, and the maximum rate should be inclusive of all charges, fees, and duties. In addition, the most-favored-nation based liberalization consistent with WTO procedures is preferable in the case of regional trade arrangements. Finally, any changes to tariff regimes should be made in accordance with a pre-determined and publicized schedule.

Given the low level of customs tariffs, the revenue consequences of further tariff reductions are likely to be limited in most CAREC countries. However, there could be significant revenue losses from the elimination of charges and other trade-distorting taxes in some countries. These losses could be offset by reducing the scope of exemptions, strengthening customs administration, and raising trade-neutral domestic taxes, in particular on consumption. Furthermore, tariff reductions should be accompanied by conversion of non-tariff barriers to tariffs

To fully exploit their benefits, rationalization and reduction of trade taxes should be part of a broad reform strategy that includes the elimination of non-tariff barriers.[14] Reductions in non-tariff barriers would also increase incentives for reforms in protected sectors, help attract foreign investment, and ensure a more efficient allocation of resources. Finally, trade liberalization in general has to be complemented by supportive macroeconomic policies, including in the fiscal and exchange rate areas, if lasting high rates of growth are to be achieved.

[14] See Krueger (2004).

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