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Trade and Institutional Environment: The International Experience and a Proposed Agenda of Measures for CAREC Countries

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CONTENTS

I. INTRODUCTION

1. In line with the Central Asia Regional Economic Cooperation (CAREC) Program's Trade Policy Strategic Action Plan (TPSAP), endorsed in November 2008, participants in the 10th Trade Policy Coordinating Committee (TPCC) meeting in May 2009 requested the preparation of a paper on trade and the institutional environment that would examine the relationship between institutions and trade expansion in CAREC countries.

2. The rationale for such a paper is the recognition that addressing institutional impediments to trade is as important as dealing with traditional tariff and non-tariff barriers when encouraging trade and economic growth. Many countries have made considerable progress on reducing the traditional impediments to trade (tariffs and non-tariff measures), but continue to lag on improving the quality of institutions. The significance of institutions for trade in the CAREC region has been emphasized in several studies by international experts. These studies have noted the importance of having efficient procedures for clearing goods at borders, licensing for exports and imports, well-organized border-region trade, and effective domestic regulations for investment, production, and business operations.[1]

3. An early draft of this study and some preliminary ideas on possible institutional measures to improve trade were presented for discussion at the 12th TPCC meeting in April 2010.[2] The present document, for discussion at the 13th TPCC meeting, reiterates—in a summarized form—the main findings of that study and presents an agenda of broad measures to improve the institutional quality in the CAREC region. The proposed measures are based on the key findings of the existing literature on institutions and trade, analysis of institutional indicators related to trade, and on inputs provided by country delegates.

4. This study is structured as follows. First, it reviews the most recent developments of the global crisis and their potential consequences for future developing country exports. Second, it summarizes the current consensus in the economic literature on the relation between the quality of institutions and trade. The paper then turns its focus to the trade-related institutional environment in CAREC countries. Finally, on the basis of the reviewed literature and the delegates' submissions, it proposes a list of broad measures to improve the trade-related institutional environment.

II. THE GLOBAL CRISIS AND DEVELOPMENT COUNTRY EXPORTS

5. In 2008-2009 the global economy suffered a severe downturn, compared by many to the Great Depression of the 1930s. [3] Although recently the world economy has begun to show signs of a modest but steady recovery in advanced economies and stronger growth in emerging and developing countries, downside risks have risen sharply.[4]

6. While the first half of 2010 showed encouraging signs of growth in private demand, there is a threat of escalation of financial stress and contagion, prompted by rising concern over

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[1] In addition to the list of references, a list of selected papers and presentations on CAREC countries is provided in Appendix 1.
[2] The full version of the background study can be found at http://www.carecinstitute.org/index.php?page=12th-tpcc-meeting.
[3] This section draws on the IMF *World Economic Outlook* (WEO) and *WEO Updates*, the UNESCAP *Asia-Pacific Trade and Investment Report* (2009), and World Bank's *Global Economic Prospects* (2010).
[4] IMF, *WEO Update*, July 2010.

sovereign risk. The ultimate effect could be lower global demand, given the existing trade and financial linkages. In addition, growth prospects in advanced economies could suffer if an overly severe or poorly planned fiscal consolidation stifles still weak domestic demand. There are also risks stemming from uncertainty about regulatory reforms and their potential impact on bank lending and economy-wide activity. Other downside risks are the possibility of renewed weakness in the US property market and insufficient international collaboration to address the challenges.

7. These downside risks to growth complicate macroeconomic management in some of the larger, fast-growing economies in emerging Asia and Latin America. Many observers fear that the depth of this global crisis—the very large macroeconomic imbalance between advanced economies with sizeable current account deficits and dynamic exporters with large surpluses—would require such a sharp correction that imports by advanced economies from developing countries could not continue expanding as in previous decades. In particular, prospects for newcomers would be closed off, which also raises concerns about the efficiency of export-led strategies.

8. The question of whether the crisis has affected prospects for continued expansion of developing country exports is of direct relevance to the work of the TPCC, given CAREC countries' aim of expanding trade. This paper argues that the crisis will result in a more competitive trading environment that calls for enhanced trade policy measures, including improvements in the quality of institutions. The question also arises as to whether the policy agenda and work program of the TPCC and other CAREC committees should be adjusted to take into account these recent developments.

Can the export dynamism of the past four decades continue?

9. The early signs of recovery are good news, but it is still possible that corrections of imbalances will restrict future export opportunities, especially for low-income countries, which are slower to integrate into global markets.[5] Cline (2008) argued even before the crisis that the correction of imbalances will result in a substantial reduction in the capacity of large-deficit countries to continue absorbing imports from developing countries. For US and UK, the share of these imports in total consumption of manufactured goods rose from 6 percent in 1998 to 11 percent in 2006. Although the numbers for other advanced economies are somewhat lower, the recent increase in imports may be unsustainable, raising fears of import restrictions. But even if that does not happen, the fact that the US needs to reduce its external deficit (over 6 percent of GDP) would by itself slow the growth of imports. This has come to be called the new "export pessimism," in reference to an analogous concern in the early eighties after the first wave of "East Asian Tigers" experienced an export boom.

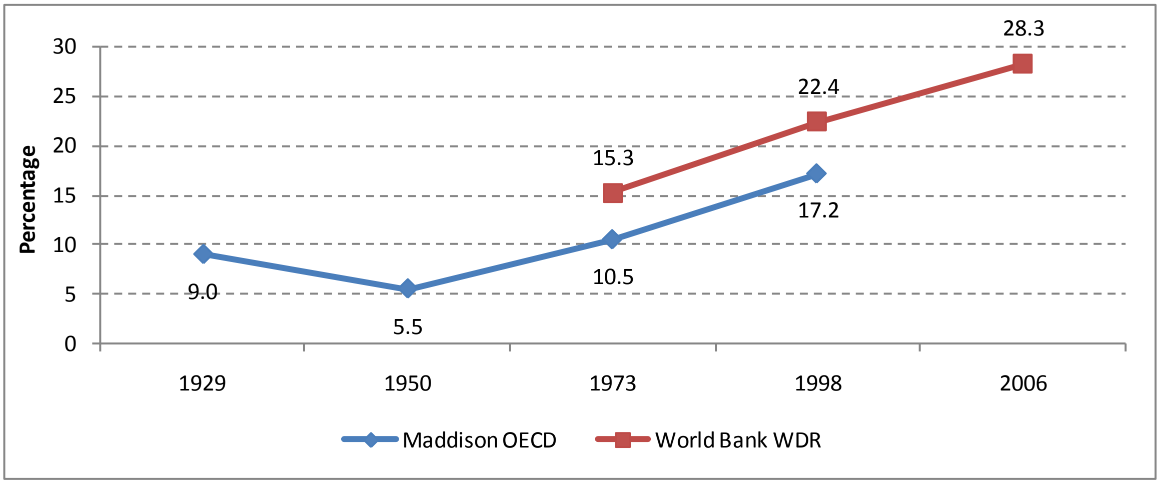
10. Nevertheless, developing countries' exports are likely to continue growing, albeit at a slower pace. Some slowdown will not be surprising given the earlier upward trend in globalization (Figure 1). The good news, however, is that protectionist measures in advanced economies have so far been limited;[6] many countries have a much stronger position than the US; and the leading exporters, as the Asian Tigers did earlier, are moving toward more sophisticated products, leaving room for new exporters. Opportunities for developing countries to trade with each other are today far greater and growing (Havrylyshyn, 2010). Whereas such

[5] For a more detailed discussion, see Havrylyshyn (2010).
[6] Bown (2010) notes many "actions" are threatened but not applied; the surge of "new" actions peaked in mid-2009, and the total of such measures around the world affects only about 0.5 percent of world trade.

trade comprised one fifth or less of exports in 1988, by 2008 this was between one third (low-income countries) and one half (upper-middle-income countries). The importance of trade among developing countries is also emphasized in UNESCAP (2009), which points out that Asian intra-regional trade is by now at least one half of the continent's exports. The implication for CAREC countries is that it is not only advanced economy markets that need to be targeted, but also other emerging markets where the competitive edge of labor costs is much sharper.

Figure 1: World Exports to GDP, 1929–2006

(In percent, unless otherwise indicated)



Sources: Maddison (2001), Table F–5 merchandise exports only. World Bank's *World Development Report* Table 4.8 includes services.

Implications for CAREC countries and the TPCC agenda

11. While the signs of recovery are comforting and suggest that excessive pessimism about global prospects was perhaps not justified, the risks of continued global difficulties remain. For individual CAREC countries, this means that their competitive edge must be enough to penetrate the new opportunities in rapidly growing developing countries. Export strategies need to be even more refined in this new environment. They should include not only consideration of the traditional instruments of liberalizing tariffs and non-tariff measures, but also look at the increasingly constraining effects of institutions at the border and behind the border.

III. HOW INSTITUTIONS AFFECT TRADE: THE INTERNATIONAL EXPERIENCE

A. Global Evidence on the Role of Institutions

12. While some differences of opinion emerge on the relative importance of institutions, the wider consensus on the links between trade and institutions can be summarized as follows[7]:

[7] Appendix 1 lists several papers and presentations discussed at the earlier TPCC meetings, which elaborate on trade impediments in general. A more detailed review of the empirical literature on the importance of institutions for trade can be found in the background study presented at the 12th TPCC in April 2010: http://www.carecinstitute.org/index.php?page=12th-tpcc-meeting.

- Institutional environment and trade facilitation conditions have an increasingly important effect on trade expansion, as traditional trade restrictions—tariffs and non-tariff measures—have declined considerably around the globe. This means that country policies must attempt to improve the quality of institutions affecting trade both directly and indirectly.
- The magnitude of trade expansion effects from improvements in the quality of institutions varies, but the consensus is that it can be very large, and often at least as large as the effect of continued tariff and non-tariff barrier reductions.
- Institutional impediments have become more important over time, but traditional restrictions are still high enough that further reduction of protection (especially non-tariff-measures and maximum tariff rates) will yield significant trade expansion.

13. Analyzing empirically the role of institutions in promoting trade, investment, and growth has now become possible, as many organizations provide data sets measuring institutional quality (Appendix 2). This paper summarizes some of the main ideas, ongoing debates, and empirical evidence in this area based on several studies relating trade openness to institutions at a general level.[8] The reliability of the institutional indices is discussed in Appendix 3.

14. **On the determinants of growth**, a recent extensive review of growth and poverty reduction experiences is contained in the *Spence Report* (2008) commissioned by the World Bank. The report recognizes that globalization can have negative consequences; that it requires complementary policies ensuring macroeconomic stability and effective institutions and governance; and that inward-oriented policies can occasionally and temporarily succeed. Nevertheless, the *Spence Report* is very clear in its principal conclusion that the historically unheard of "growth of 7 percent per year sustained over 25 years (was made) possible only because the world economy is now more open and integrated." This confirms the broad consensus in the development community that trade liberalization, outward orientation, and generally market-friendly policies are more effective in promoting growth than inward oriented and government-directed efforts.

15. **On the issue of understanding how institutions affect trade*,*** Ikenson (2008) summarizes the recent literature on institutions and trade by saying, "Countries can derive large gains from the trading system by engaging in reforms often referred to as trade facilitation."

16. In general, there is a strong consensus that institutions are important. However, a concern arises that, since empirical studies use only broad measures of institutions, they cannot tell policy makers *how* to improve these institutions. As Hoekmann and Nicita (2008) note, much work needs to be done to "unpack" these various effects: Which institutions are most important? What actions can be taken in different countries to improve institutions?

B. Institutions and Trade: The Asian Experience

17. Asia's experience with the role of institutions in trade has also been a subject of many new studies, including analytical papers by academics and researchers of international organizations. In particular, extensive work has been done under the aegis of the Asian Development Bank Institute (ADBI) and UNESCAP-ARTNeT. [9] Several recent reports of the

[8] Details on various studies and a full list of references can be found in the full version of the paper at http://www.carecinstitute.org/index.php?page=12th-tpcc-meeting.

[9] Asia-Pacific Research and Training Network on Trade. Information on the network, reports, bulletins and all working papers are available online at www.artnetontrade.org.

ADBI and UNESCAP have not only summarized the main findings of such studies, but have also gone far towards elaborating practical policy actions aimed at improving the institutional environment and reducing impediments to trade. The main conclusions of the relevant studies can be summarized:

- The relative importance of institutions and trade-facilitating measures has increased over time in Asia.

- Within Asia there is a wide diversity in the quality of institutions, with East Asian economies and the People's Republic of China (PRC)—the dynamic exporters—having achieved far better positions than others regarding institutional impediments and trade facilitation measures.

- In general, the landlocked economies, including Central Asia, are less advanced on institutional development, although there are individual exceptions.

18. International financial institutions (IFIs), and UNESCAP have ongoing activities with the goal of improving institutional conditions. The full complex of national and regional activities addressing institutional improvement in Asia is the subject of two recent reports: UNESCAP (2009) *Asia-Pacific Trade and Investment Report*; and the joint report of ADB and UNESCAP (2009) *Designing and Implementing Trade Facilitation in Asia and the Pacific*. More specifically for CAREC countries is the parallel work of the CAREC Customs Cooperation Committee, detailed in the 2009 ADB Report *CAREC Transport and Trade Facilitation: Partnership for Prosperity*.

IV. INSTITUTIONAL IMPEDIMENTS TO TRADE IN CAREC COUNTRIES

19. Various studies on Asia analyze the differences in institutional environment and trade facilitation in sub-regions, and conclude that "landlocked countries" (which include all CAREC countries except PRC) do least well in the rankings, whether the indicator used is trading-across-borders, number of documents required, time for document preparation, or the general logistics performance indicator. The analysis of CAREC countries presented here confirms this view, but also shows that there have been many recent improvements.

Institutional Indicators for CAREC countries

20. Institutional and logistics indicators are available at three levels of detail. Table 1 provides the broad overview for CAREC countries and a comparison with other regions using the first level of generality from three data sets: The World Bank's *Doing Business Reports*, the World Bank's *Logistics Performance Ranking*, and the World Bank's *Governance Indicators*. The comparator regions chosen are the dynamic East Asian Exporters and East Europe and Commonwealth of Independent States (CIS), excluding Central Asia.[10] These comparator groups have been chosen because they have demonstrated strong export performance in recent decades. Given that most CAREC countries are transition economies that aspire to become major exporters, it is of interest to compare them to other countries in that category.

[10] The country coverage can be seen in Appendix 4 with values for individual countries.

21. For the *Ease of Doing Business* and *Logistics Performance Indicators* in 2009, CAREC countries ranked at about the middle of the range for all countries (94 of 183).[11] While this is a reasonable performance, three qualifications are needed:

- First, if the most dynamic exporters of recent years are considered as the examples to emulate, CAREC countries' position begins to look weaker;
- Second, there is considerable variation within CAREC countries, with some of them having rank values of 150 or worse, and others comparable to the most dynamic competitors, about 70 and better; and
- Third, the governance indicators show that CAREC countries are well below the middle of the range—in fact, no individual country reaches the 50th percentile on any of the three indicators (regulatory quality, rule of law, and control of corruption).

Table 1: Overview of Institutional Indicators, Latest Years: CAREC and Comparator Countries

	Ease of Doing Business Rank	LPI Rank 2010	Regulatory Quality Percentile Rank	Rule of Law Percentile Rank	Control of Corruption Percentile Rank
Dynamic East Asian	**52**	**33**	**40**	**43**	**49**
C. Europe & CIS (ex. Central Asia)	**68**	**70**	**37**	**48**	**48**
CAREC	**106**	**96**	**70**	**81**	**84**
Afghanistan	160	143	96	100	99
Azerbaijan	96	89	57	75	86
PRC	83	27	54	55	59
Kazakhstan	71	62	60	76	84
Kyrgyz Republic	94	91	58	92	87
Mongolia	52	141	57	65	68
Tajikistan	153	131	84	88	86
Uzbekistan	138	114	94	90	89

CAREC = Central Asia Regional Economic Cooperation; LPI = Logistics Performance Index; PRC = People's Republic of China

Sources: Latest available values from World Bank reports: *Doing Business 2010, Connecting to Compete 2010, and World Governance Indicators 2009*. The governance indicators have been converted for consistency with other indicators, so that the lower rank value is always better.

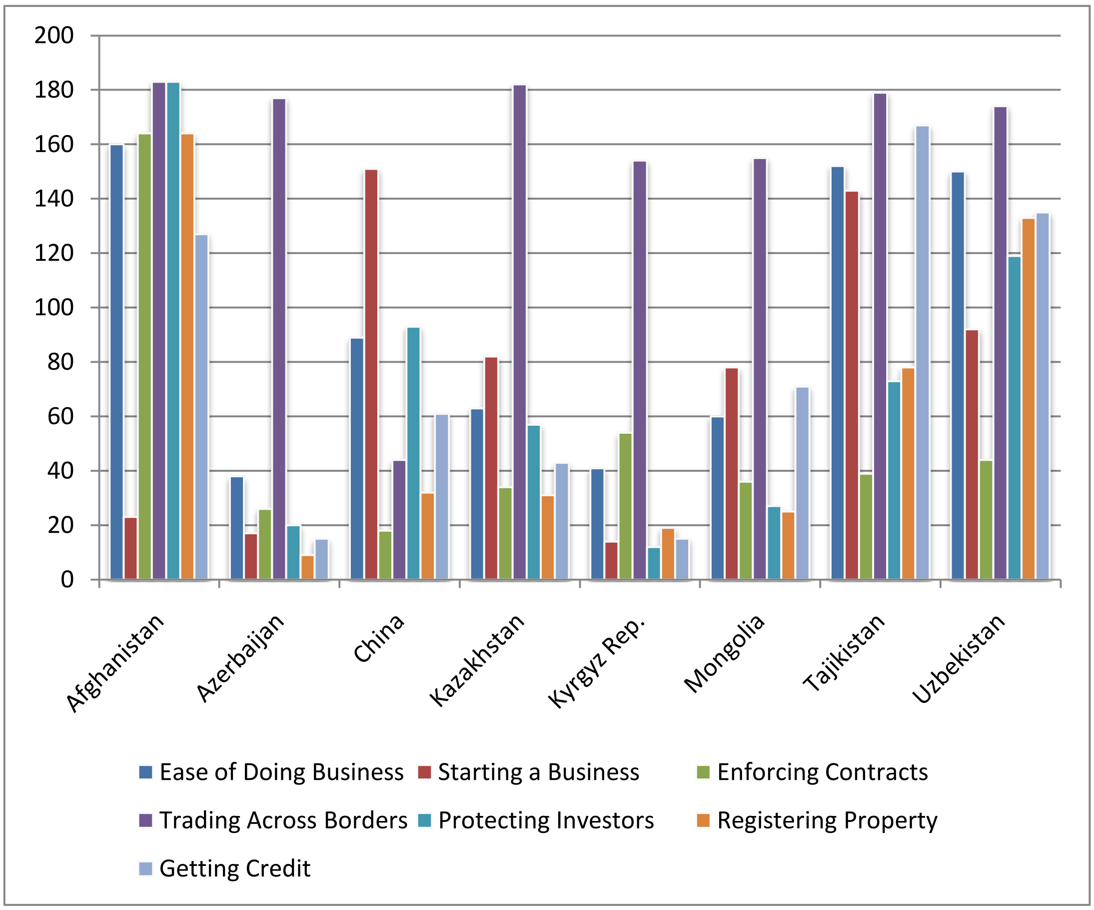
22. The *Ease of Doing Business* data comprise several categories allowing separation of elements that have indirect effect on trade from those that have a direct impact—the latter captured in the various components of *Trading across Borders* indicators. Figure 2 shows the

[11] For comparison the regional averages were: OECD-30; Central and East Europe - 68**;** East Asia and the Pacific - 83; Middle East and North Africa - 92; Latin America - 95; South Asia - 118; Sub-Saharan Africa - 139.

latest rankings for six such categories in each CAREC country. These results are diverse, underlying the point that recommendations should be tailored to specific country situations.

- The first observation is that there is considerable variation among the categories, except perhaps in Afghanistan. Some countries score well on starting a business, but worse on trading across borders; other countries score well on enforcing contracts but poorly on protecting investors.
- The second observation is that the indicators for trading across borders are generally much worse than those for other categories, except in PRC. PRC has indeed one of the best export performance records, reflecting its strong trading across borders ranking. But more relevant to this paper is the guidance this gives for focusing on the third-level indicators under the trading across borders category.

Figure 2. Selected Components of Doing Business Indicators: CAREC Countries, 2010



Source: World Bank, *Ease of Doing Business 2010*

23. Table 2 gives details on some of the specific and more concrete impediments to trading across borders reported in *Doing Business 2010*. Taking PRC as a benchmark, the big difference is in the time needed to export or import, and to a lesser extent in the number of documents needed. Days to enforce contracts and number of procedures in PRC and other CAREC countries appear very similar. However, if one looks at a further level of detail (Figure

3), including a breakdown for export time, it becomes clear that documents preparation is a serious impediment in most CAREC countries.

Table 2. Trading Across Borders and Enforcement of Contracts: CAREC Countries

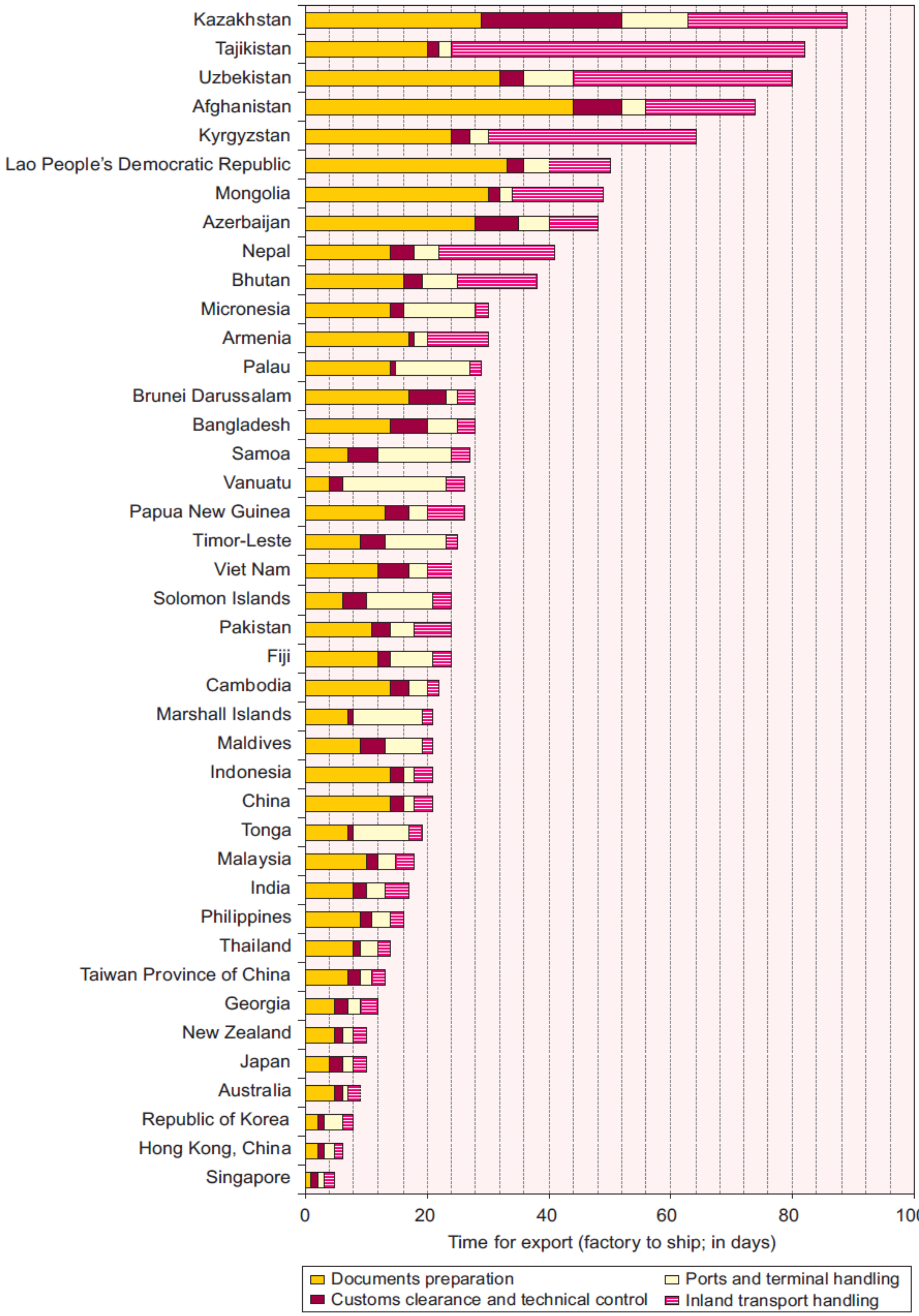
	Trading Across Borders				Enforcing Contracts	
	Number of Documents to Export	Number of Documents to Import	Time to Export (Days)	Time to Import (Days)	Number of Procedures	Days to Enforce Contract
Afghanistan	12	11	74	77	47	1,642
Azerbaijan	9	14	46	50	39	237
PRC	7	5	21	24	34	406
Kazakhstan	11	13	89	76	38	390
Kyrgyz Rep.	7	7	63	72	39	260
Mongolia	8	8	46	47	32	314
Tajikistan	10	10	82	83	34	430
Uzbekistan	7	11	71	92	42	195

Source: World Bank, *Ease of Doing Business 2010*

24. Figure 3, expanding on the "export time" component, makes it clear that the other CAREC countries' disadvantage relative to PRC is partly related to being landlocked and thus needing more transport time for the ports and terminal handling, and for the inland transport handling. But it is equally clear that a large part of the total difference is attributable to the time needed for documents preparation and customs clearance procedures. Thus, reducing the number of documents may not be enough if their complexity and turn-around time is not also reduced.[12] In general, it would appear that in CAREC countries there remains a problem with documents preparation.

[12] This has often been found in earlier experience of simplification of export-import procedures. It can be even more bedeviling, as sometimes even after formal rules are established on the maximum time for approving documents, officials undermine this by returning documents as "incomplete."

Figure 3. Components of Export Time



Source: UNESCAP, *Asia-Pacific Trade and Investment Report 2009*, Fig. 4.3.

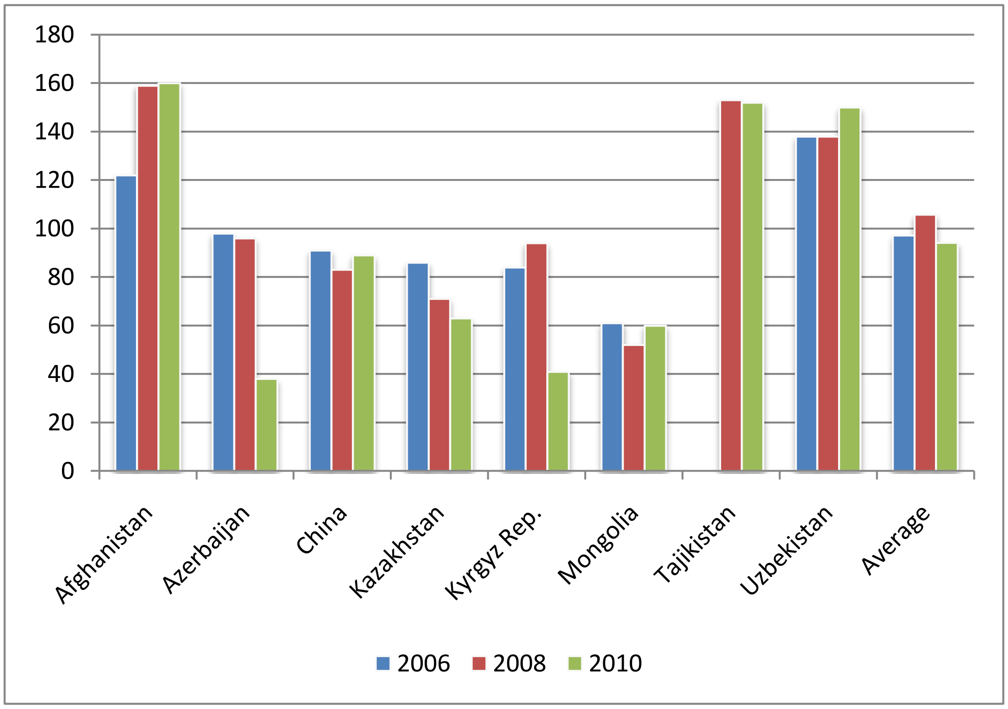
25. Overall, the data comparison confirms the conclusion reached by many of the studies on Asia: that significant efforts are needed to improve institutional quality, and in particular reducing

impediments that affect trading across borders. In fact, country authorities have recognized this, and in recent years considerable improvements have been made in most of these indicators, and actions are ongoing in most countries.

Recent improvements in institutional environment indicators in CAREC countries

26. In most CAREC countries, the *Ease of Doing Business* indicator has improved since 2006, only modestly in some cases but substantially in Azerbaijan, Kazakhstan and the Kyrgyz Republic (Figure 4). But even those countries for which the index remained high, many selective improvements were made in the individual components (the six areas of Figure 2).

Figure 4. Overall Index for Ease of doing Business CAREC Countries 2006–10



Source: World Bank, *Ease of Doing Business 2010*

27. In Afghanistan, significant improvement was achieved in ease of getting credit (the ranking improved from 177 to 127), and the already good ranking on starting a business improved slightly. Azerbaijan undertook reforms which markedly improved its ranking in starting a business (the rank improved from 64 to 17), getting credit (from 26 to 15) and more modestly in enforcing contracts (from 30 to 26). PRC implemented measures to make getting credit easier (the rank improved from 84 to 61).

28. In Kazakhstan, steady improvement is visible, especially on the registering property ranking (72 to 31). The Kyrgyz Republic undertook a wide set of actions that improved its rankings in starting a business (49 to 14), getting credit (68 to 15), investor protection (33 to 12), and more modestly in trading across borders (177 to 154). Mongolia saw some small ups and downs in several components but importantly achieved progress in trading across borders (168 to 155).

29. In Figure 4, Tajikistan and Uzbekistan appear to perform less well than other CAREC countries on the *Ease of Doing Business* indicators.[13] However, both took positive measures in some areas. For Tajikistan, conditions for starting a business improved (the rank changed from 161 to 143), as well as getting credit (167 to 135) and investor protection. Uzbekistan made strong improvements in getting credit (the rank changed from 170 to 135), and some modest progress for enforcing contracts (48 to 44). As a sign of significance of these improvements, Azerbaijan, PRC, the Kyrgyz Republic, and Tajikistan were included by the World Bank *Doing Business Reports* in the list of top 10 reformers within the last 3 years.

30. Unfortunately, progress with other institutional impediments to trade has not been as strong. With the exception of moderate improvements for the Kyrgyz Republic (the rank changing from 177 to 154) and Mongolia (168 to 155), the CAREC countries have not made much progress on the trading across borders category—though PRC was already in a very strong position. This echoes the evidence of Figure 3 above, suggesting that considerable possibilities exist for improving the conditions for trading.

31. At the same time, the trade facilitation dimensions of trading—*Logistics Performance Indicators* in Table 3—have undergone substantial improvements, as seen in the considerably better 2010 rankings of the *Logistics Performance Indicators* for all countries, and very substantially for Kazakhstan, the Kyrgyz Republic and Uzbekistan. The World Bank (2010) report *Connecting to Compete* designated PRC, Uzbekistan and the Kyrgyz Republic among the Top 10 Performers within their income group. If there can be such progress in these areas, it gives hope for the possibility of similar dynamics for the institutional impediments under the trading across borders category.

Table 3. Trading Across Borders and Logistics Performance Index: CAREC Countries, 2008–2010

	Trading Across Borders		LPI	
	2008	2010	2008	2010
Afghanistan	174	183	151	143
Azerbaijan	173	177	111	89
PRC	42	44	30	27
Kazakhstan	178	182	134	62
Kyrgyz Rep.	177	154	103	91
Mongolia	168	155	137	141
Tajikistan	176	179	147	131
Uzbekistan	165	174	130	68

LPI = Logistics Performance Index; PRC = People's Republic of China
Sources: World Bank, *Ease of Doing Business*, World Bank, *Connecting to Compete*

32. The many recent improvements are highly commendable, though some caution about their sustainability is needed. Experience even for the most advanced transition countries shows that governance and institutional improvements are very fragile, especially in their

[13] Given the low precision of the index and the fact that it is a relative measure (if a country X makes no change while others improve, Ease of Doing Business deteriorates for X) a small rise in the rank should not be taken as significant.

implementation. Gersl (2006) points out that, even for the Czech Republic and other new European Union (EU) members, while formal criteria of institutional achievements are very high and meet easily EU expectations for new members, the implementation is still problematic.

33. In addition to comparing the annual rankings of the countries, the World Bank's *Doing Business* indicators can also be used to analyze the year-to-year changes in the actual values of each indicator.[14]

34. The findings for some of the *Doing Business* indicators during 2006-2010 are shown in Figures 5 and 6. Over the past five years the CAREC countries have made good progress in starting a business indicators. On the other hand, only limited progress can be seen in trading across borders, getting credit, and protecting investors.

[14] For the complete values of *Doing Business* indicators, see the historical data set available at http://www.doingbusiness.org/CustomQuery/.

Figure 5. Trading across borders indicators, 2006–10

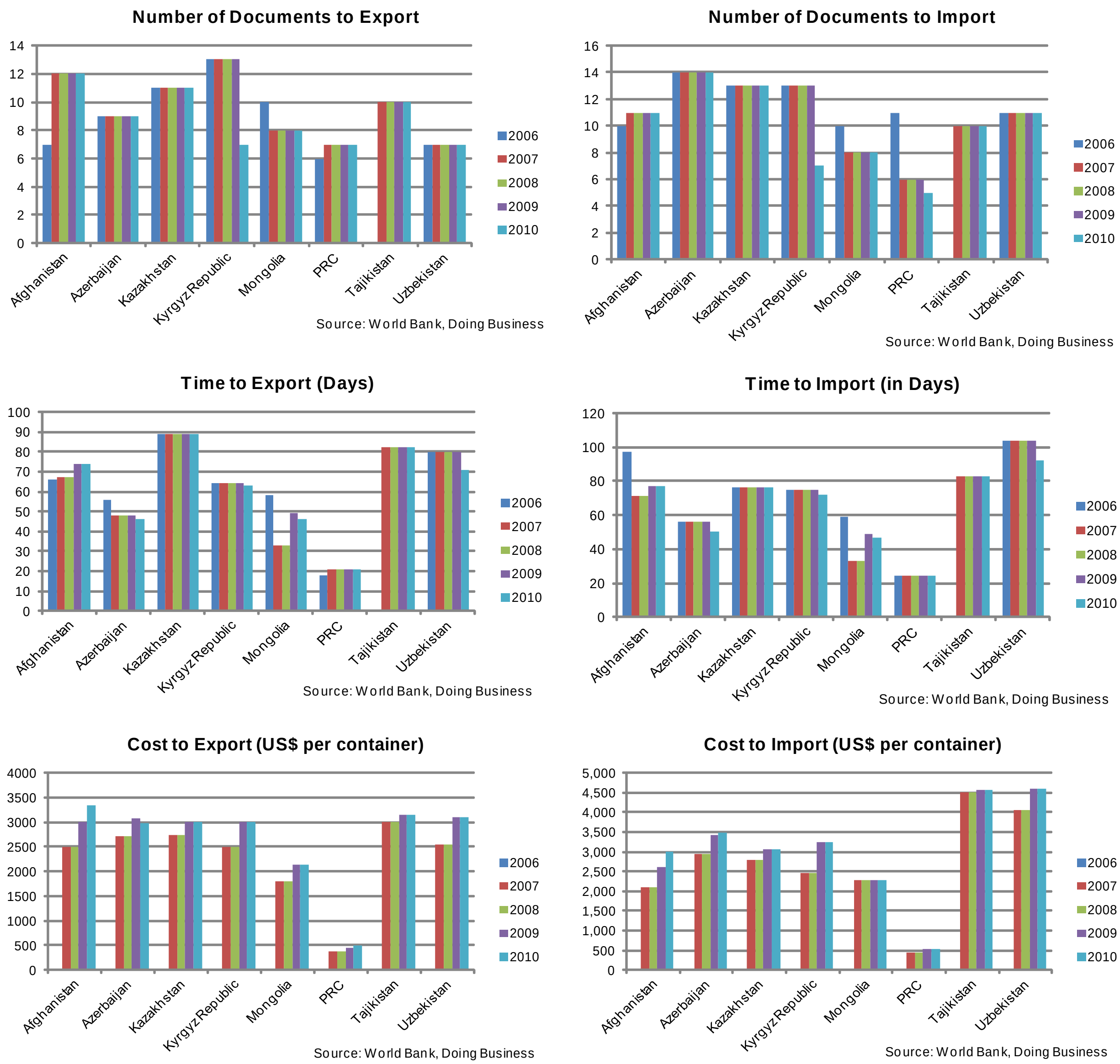
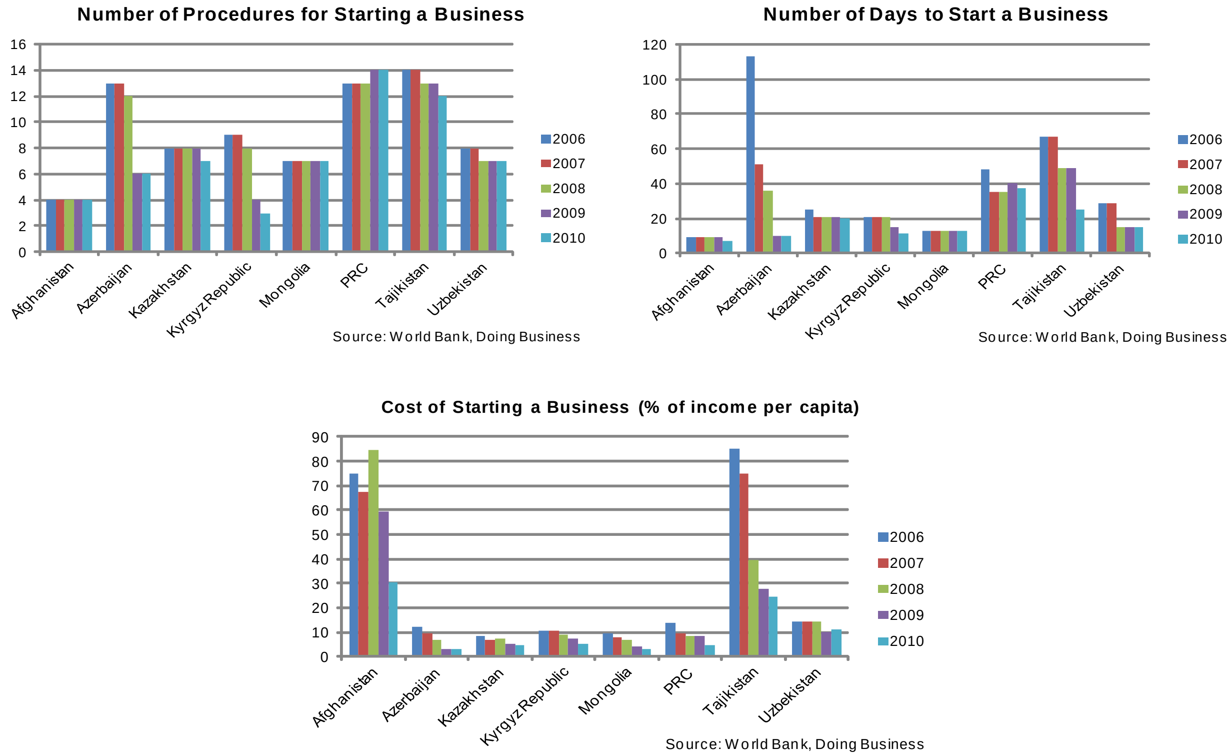


Figure 6. Starting a business indicators, 2006–10



35. On the basis of the analysis above, the main findings on the institutional issues affecting trade in CAREC countries can be summarized as follows:

- In recent years, CAREC countries have undertaken measures to improve institutional quality, with a resulting improvement in many of the indicators. A few countries have seen significant improvements in several dimensions of doing business rankings and have been designated by the World Bank as among the top 10 performers in some years. Others may not have moved forward as much, but all have improved on some of the dimensions.
- Despite this progress, in 2009 CAREC countries still ranked at only about the middle of the range of developing countries on the *Ease of Doing Business* and *Logistics Performance Indicators*. PRC scored much better, however, especially for elements directly related to trade. The *Governance Indicators* reveal an even weaker relative position.
- Empirical estimates show that Asia could increase exports by nearly 30 percent by improving institutional quality to Organization for Economic Cooperation and Development (OECD) levels. The effect for CAREC countries is likely to be even larger, since these indicators, with the exception of PRC, are not as favorable as those for Asia as a whole.
- Based on the *Ease of Doing Business*, indicators on trading across borders are especially lagging in CAREC countries—again with the exception of PRC. This suggests that the focus for many countries should be on such elements. Other elements, such as

protecting investors and getting credit, are also weak in some countries. Thus, the list of priorities for each country should probably include some measures in these areas.

- Among the concrete impediments to trade that various studies identify as particularly problematic in CAREC countries (PRC excepted) is the long time required for documents preparation. In some countries this is due to the large number of documents required, while in others to the number of agencies that must approve such documents. Such analysis helps to pinpoint what might be done to improve the situation.

V. HIGHLIGHTS OF DELEGATES' SUBMISSIONS

36. The submissions provided by country delegates have varied in the level of comprehensiveness and detail. They have covered both at-the-border institutional impediments and key dimensions of behind-the-border issues.

37. In fact, the submissions reflect the different circumstances of each country with respect to the stage of institutional development and the ongoing efforts to make improvements.[15] They emphasize different features of the institutional environment, but there is a high degree of commonality in several aspects of the envisaged institutional measures. The most notable highlights and common elements are:

- Simplification of the number and complexity of procedures for clearance, licensing, payment of duty, etc.
- Improvement of facilities at the border.
- Establishment of single-window systems.
- Better implementation of electronic processing of documents.
- Strengthening behind-the-border services related to trading such as banking, credit, insurance, and regulatory activities.
- Establishment of maximum time limits for document processing.

38. The individual country inputs to this study are summarized here in order to provide more detailed insight to how the country delegates perceive the institutional environment in their countries and how they propose to address the institutional impediments to trade.[16]

39. Azerbaijan's inputs described the recent actions to address institutional impediments, including (i) recent changes in excise taxes and tariff levels; (ii) progress on developing a single window at border crossing points and transferring functions from other ministries and agencies to the State Customs Committee; (iii) revisions to the customs code which are now under consideration; (iv) progress on an electronic single administrative document; and (v) the gradual introduction of a risk management system.

40. Inputs from Kazakhstan highlighted some of the reforms that have been or are being implemented in response to the *Doing Business 2009* report. Measures in 2009-2010 consisted of new laws or amendments to existing laws, and administrative reforms in the following areas: business registration; protection of investors; integrated border control; simplified customs procedures; and posting trade information on the Internet. Work in progress includes a process

[15] Countries that have not made submissions or have provided more limited inputs may in fact find themselves at a well-advanced stage, with conditions for trade that rank very high on international comparisons.
[16] Not all CAREC countries submitted inputs.

for prioritizing creditors in bankruptcy cases (set for 2011); consideration of a draft electronic single window concept; and introducing a risk management system for customs control.

41. The Kyrgyz Republic's inputs noted that the authorities are focused on reducing the administrative barriers at borders and simplifying customs procedures. The government identified the lack of automation and modern technology at border points, overlapping control procedures among government agencies, and poor physical infrastructure at border crossings as the major impediments to trading across borders. The one-stop principle is being introduced at cross border points. The Kyrgyz government also suggested some practical short-term measures to address the institutional impediments: (i) require agencies to justify current goods inspection processes, such as radiation control for all goods; (ii) promote awareness of documents or procedures that have been annulled; (iii) reduce the number of agencies involved in cross border inspections; and (iv) conduct a review of contract-related legislation and court practices, followed by appropriate recommendations for judicial reform.

42. Inputs from Mongolia were submitted by the Trade and Development Bank and the Mongolia Chamber of Commerce. The Trade and Development Bank provided information on credit eligibility and the requirements for obtaining credit by businesses and individuals, while the Chamber of Commerce provided alternative figures for the costs of trading in Mongolia and comparisons with neighboring countries.

43. Tajikistan's submission identified major impediments related to inter-agency linkages, collateral, and procedures not specified in laws. Databases of the various agencies handling business registration are not linked, and each agency issues a different identification number. The proposed solution to this problem is a single window for business registration. To improve access to credit, it has been proposed to amend the law on pledging real estate. One of the main impediments to trading across borders is the requirement to obtain a statement for products not subject to certification. Traders must submit such a statement despite the absence of this requirement in the customs law. The proposed solution was to reduce the number of required documents to three and make them into a single administrative document.

44. Inputs from Uzbekistan addressed the five categories of *Doing Business* indicators. Key impediments were identified and solutions proposed. One of the impediments on starting a business is the high amount of paid-in capital for domestic businesses. A recommendation was made to grant domestic firms the same privileges that foreign investors receive. On getting credit, the suggested measures entailed drafting a law on regulating credit bureaus and establishing a credit information sharing system. Institutional bottlenecks in trading across borders include the large number of documents that must be filed and the lengthy delay in value-added tax refunds for exports. Lastly, the enforcement of contracts is particularly problematic for disputes with foreign partners, and Uzbekistan does not have an international arbitration law or arbitration court.

VI. PROPOSED AGENDA OF MEASURES TO IMPROVE INSTITUTIONS AFFECTING TRADE

45. Both the broad international experience and the country submissions cover a large set of possible government actions to improve institutions and facilitate trade. Given that adopting and implementing these actions will require a long-term program, it would be optimal to focus on a small number of feasible measures to be taken in the next few years.

46. The proposed areas of action affect all countries. However, different countries are at different levels of institutional development, have diverse priorities, and have different administrative procedures. Therefore, the starting points and paths chosen will vary according to the individual circumstances.

47. The proposed agenda includes measures which fall into three broad categories: (1) improving and simplifying procedures for exports and imports; (2) improving the general business environment; and (3) deepening the financial system to improve access to credit. As shown by the delegates' submissions, these measures are considered by the CAREC countries to be both important and feasible for implementation.

48. The first group of measures has a more direct impact on external trade. These measures are found, for example, in the *Doing Business Report* under the category "trading across borders." The main emphasis in this area is simplifying the procedures for exports and imports, as well as for export and import licensing. As the global experience shows, the biggest obstacle is often the existence of multiple agencies requiring documents and clearance. Therefore, the most direct way to avoid redundancy is the movement towards a single-window, first at the border and then also for trade licensing. Other important steps include reductions in the number of documents required for conducting trade transactions as well as the number of inspections (customs, sanitary, etc.). The elimination of special customs rates and exemptions from customs duties for various categories of goods would generate further gains.

49. The other two groups of measures relate to the domestic economic environment more generally. Their impact goes far beyond the improvement in the trade environment, but they are also considered to have a significant—albeit indirect—effect on trade. The order in which the measures are presented in Table 4 does not indicate their relative importance or the preferred sequence in time.

50. With respect to the timetable, flexibility is appropriate not only because many of these institutional measures require several sequential steps and inter-agency coordination—which all take time—but also because individual CAREC countries are at different stages in their efforts to improve the quality of institutions. [17] The time frame for implementation and subsequent monitoring by the TPCC would need to cover the next 2-3 years, similar to the current TPSAP time frame, with spring of 2011 being the time to finalize the countries' proposed measures and expected actions. Given the complexity of the institutional agenda, many countries may consider establishing an inter-agency committee or working group to coordinate government actions on institutions.

[17] For most of the listed measures, country officials would need to 1) draft proposals for new regulations and/or laws if needed; 2) seek approval of those proposals by the appropriate constitutional mechanism; and 3) publish and distribute the new procedures throughout the administration and to the public.

Table 4. Proposed Agenda of Measures to Improve Institutions Affecting Trade

Proposed Measures	Country Submissions that Included the Measure[18]	Comments
1. Improve and simplify procedures for exports and imports		
a. Reduce the time needed to export or import by simplifying procedures for border crossing and clearance, including reduction in the number and complexity of documentation for exports and imports. In particular, eliminate submission of documents to multiple agencies for clearance.	AFG, AZE, KAZ, KGZ, TAJ	Several studies have found this to be one of the most important measures that countries should take to achieve an environment more comparable to that of the dynamic Asian exporters. Application generally requires the introduction of a "single window" and as much implementation of electronic processing as possible. This can be combined with the elimination of special customs rates and exemptions from customs duties.
b. Simplify procedures for import/export licenses, for example by implementing a "single window" and reducing the number of clearing agencies for licensing and customs clearance.	AZE, KAZ, KGZ, TAJ	A "single window" for initial licensing of export and import operations is technically separable from a "single window" for customs clearance, and each of these measures has a separate beneficial effect. Simplified licensing would encourage domestic agents to engage in external trade.
c. Reduce the amount of time by which clearing agencies must respond to document submissions and ensure enforcement by the appropriate overseeing authorities.	AFG, AZE, KAZ, KGZ	This measure has the additional aim of reducing possibilities for corruption. However, a time limit can usually be circumvented through a claim that a document is not properly completed. A thorough and regular audit of the compliance with time limits is therefore needed. Enforcement is a potentially broad legal issue.
2. Improve the general business environment		
a. Simplify procedures for starting a business	PRC, TAJ	Among the measures with indirect effect on trade, this has been often emphasized in assessments as well as is in the country delegates' inputs. Submissions of several countries note the ongoing efforts in this area, and the advisory support of World Bank and other experts.[19]
b. Improve investor protection for both domestic and foreign investors	AFG, AZE, KAZ, MON, PRC, UZB	Several studies show that this measure can have a considerable impact for trade promotion.[20] Investor protection is important not only for large, but also medium and small enterprises.

[18] The list reflects the information provided by TPCC delegations. It does not attempt to differentiate the stages of the process at which countries may be currently. For example, countries where border procedures are already efficient may not have indicated proposed actions because they are not a high priority for them.

[19] While at this stage it is probably right to focus on starting a business, it should not be forgotten that a complex and costly process of closing and bankruptcy has been shown in many advanced economies to be a deterrent to starting a business, and should eventually be addressed as well.

[20] The latest World Bank project on institutional indicators, *Investing Across Borders 2010*, focuses on investor-related dimensions.

3. **Promote deepening of the financial system**		
a. Improve quality and availability of credit information	AFG, KGZ, MON, TAJ, UZB	This could include the creation of a credit risk registry, wider availability of information on creditors, and a centralized registry system for enterprises and ownership, as well as for mortgages and movable collateral.
b. Clarify legal rights of borrowers and creditors	AZE, KAZ, KGZ, TAJ, UZB	Listed in the *Doing Business Reports* among the necessary steps to be taken to improve credit access.
c. Improve access to finance for SME exporters	AFG, AZE, KAZ, KGZ, TAJ, UZB	One possible step is establishment of export credit facilities, which must be done with great care to avoid subsidization (which is contrary to WTO rules), and to allow efficiency considerations to prevail in decisions for credit support. All microfinance institutions should be subject to financial regulation and supervision.

AFG = Afghanistan; AZE = Azerbaijan; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; MON = Mongolia; PRC = People's Republic of China; TAJ = Tajikistan; UZB = Uzbekistan

VII. CONCLUSIONS AND ISSUES FOR DISCUSSION

51. In line with recent research on the possible impact of the global crisis on trade and competitiveness, this paper argues that the crisis will result in a more competitive global trading environment in which CAREC countries must compete. The need to correct global imbalances is expected to reduce the capacity of countries with large current account deficits to continue absorbing imports from developing countries. In this new environment, enhanced trade policy measures, including improvements in the quality of institutions, would help countries to become more competitive. This conclusion corroborates the importance of institutions for trade in the CAREC region, an issue that has been emphasized in several studies by international experts.

52. Country delegates' submissions on the identified institutional impediments to trade show a commendable degree of awareness of the problems that CAREC country authorities are facing. Moreover, while progress is uneven across countries, steps are being taken to address those impediments, and some countries are already well advanced in implementing some of the proposed measures. However, there is a need for countries to prepare and share more specific plans and experiences in dealing with the institutional impediments to trade.

53. The measures proposed in this paper are based on existing studies on the subject, analysis of widely-accepted indicators, previous discussions within CAREC, and the delegates' inputs. The proposed measures cover actions to simplify trade procedures, improve the general business environment, and deepen the financial system to improve access to credit. These measures are not specifically tailored to each country's unique institutional environment; instead, they provide a menu of actions that hopefully provides sufficient basis to develop a country-specific plan to adequately address the existing institutional impediments to trade.

54. The discussion of this study at the 13th TPCC meeting should allow delegates to become fully aware of the developments and achievements in other CAREC countries. In line with its mandate, the TPCC provides a forum for countries to discuss common trade policy issues and jointly monitor progress in implementation of actions to address them relative to clear benchmarks and timeframe. This joint monitoring is currently focused on the implementation of the TPSAP, which includes the identification of the most important institutional development shortcomings that affect trade in CAREC countries. The TPCC also provides countries with the opportunity to request specific technical assistance from the relevant multilateral institutions, as

well as from the other CAREC committees, such as the Customs Cooperation Committee (CCC).

55. The study helps to direct the CAREC countries' attention to institutional issues that, if addressed by appropriate policy measures, could improve the environment for trade. The study's purpose was not to pinpoint precisely the actions needed in each country. The agenda in Table 4 contains broad issues in which the specific needs (and where to start) could vary widely from country to country. TPCC delegates will have to take these findings back to their respective authorities and determine what actions are currently being implemented and which additional measures, if any, they wish to take to address the institutional impediments to trade.

56. For discussion at the 13th TPCC meeting:

- ***What actions should the CAREC countries and the TPCC pursue in response to this study's findings?***
- ***In particular, do delegates agree that this paper provides them the basis for reporting – after consultation with their authorities – country-specific proposals on measures to be taken to deal with the institutional impediments to trade? These plans would include the proposed timeline and the indications of possible technical assistance needs.***

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Appendix 1. Selected Papers and Presentations at TPCC Meetings Analyzing Trade Impediments in CAREC Countries

Asian Development Bank, “Trade Barriers in Central Asia,” paper presented at CAREC Senior Officials’ Meeting, January 2006.

Asian Development Bank, “Barriers to Transit Trade in Central Asia,” paper presented to TPCC meeting, October 2005.

CAREC Training Seminar, Almaty, June 2007 (included several papers and presentations on various aspects of trade promotion, barriers to trade, creating an environment for foreign investment, global and regional integration).

CAREC, “Trade Policy Coordinating Committee Status Report for Senior Officials Meeting,” Manila, September 2007.

CAREC. “Trade Policy Coordinating Committee Status Report for the Sixth Ministerial Conference,” Dushanbe, November 2007.

CAREC. “The Trade Policy Strategic Action Plan,” TPCC and SOM Meetings, Baku, September 2008.

CAREC. “Summary of Proceedings of the Senior Officials’ Meeting,” Baku, May 2009.

Elborgh-Woytek, Katrin and Azim Sadikov. “Attracting and Maximizing the Benefits of Foreign Direct Investment,” Presentation at CAREC training seminar, Almaty, June 2007.

Lohmus, Peter. International Monetary Fund, “Trade Taxes in Central Asia,” paper presented at CAREC training seminar, Almaty, June 2007.

Pomfret, Richard. “Quantitative Restrictions on Trade,” paper presented to 7th TPCC meeting, Manila, September 2007.

World Bank, “Cross-border Trade within Central Asia,” paper presented to TPCC meeting, Manila, September 2007.

Appendix 2. Data Sets on Institutional Quality

A large number of international organizations provide measures of institutional quality, broadly summarized in the form of indices, rankings, or global trend values. The World Bank has created three such data sets dealing with governance matters, the ease of doing business, and trade logistics performance. While the focus of these three independent projects is different, the aim is the same: to provide tools for individuals as well as governments to identify the challenges and opportunities present in the various areas examined. The indicators are also meant to serve as a benchmark for international comparison to assist countries in the formulation of relevant policy.

The Governance Matters project, providing measures of *Worldwide Governance Indicators* (WGI), started in 1966, is the first of the three data sets. The original goal of this initiative was to inform, initiate debate, facilitate research, and raise awareness regarding governance matters. The data set presents aggregate and individual governance indicators for 212 countries and territories and is one of the most complete cross country data compilations on issues relating to governance. The quantitative measurements reflect the views of various stakeholders ranging from households to area experts from nongovernmental organizations (NGOs). The indicators focus on six broad aspects of governance: 1) voice and accountability, 2) political stability and absence of violence/terrorism, 3) government effectiveness, 4) regulatory quality, 5) rule of law, and 6) control of corruption. The individual components of the six indicators along with the aggregate measurements are offered as text, data, or interactive databases at www.govindicators.org.

The newest dataset, *Connecting to Compete*, was published for the second time in 2010. It is built around the *Logistics Performance Index* (LPI), a multifaceted evaluation of domestic logistics related to trading. It is based on 5,000 evaluations of nearly 1,000 logistics professionals. Apart from the overall country-specific LPI ranks and scores intended to assist policy making on trading logistics, the measurements serve as an international benchmark tool. The report provides six individual indicators for more detailed analysis: 1) customs, 2) infrastructure, 3) international shipments, 4) logistics quality and competence, 5) tracking and tracing, and 6) timeliness. The data set comprising the various indicators, along with analysis, is published every two years. Along with the report, interactive databases and quantitative data are readily available at go.worldbank.org/ 88X6PU5GV0.

Appendix 3. Reliability of Institutional Indicators

The increasing availability of quantitative measures for the quality of institutions is a very positive development in helping to design concrete policy actions. But these indicators do not have the same objective quality as many other economic statistics such as output, exports, or inflation. Although the latter are always subject to measurement error, they all have a natural metric. Quality of judicial institutions concerning contract enforcement cannot be measured naturally- the existence of laws is not a good measure, as in the end it is the effectiveness, fairness, and speed of implementation that matters. The architects of institutional indicators have therefore largely relied on subjective measures of what users of institutions or unbiased observers perceive to be the effectiveness of the institutions. But this naturally raises the question of the accuracy and reliability of such subjective measures.

The problem has been explicitly addressed by analysts. Hallward-Driemeier and Alterido (2009) used the vast data set of the World Bank's *Enterprise Surveys* database, with 79,000 firms in 105 countries giving subjective perceptions on 17 dimensions of business impediments (e.g., licensing procedures), but also providing objective measures on the conditions and performance of the firms (e.g., actual costs for dealing with licensing procedures). The authors find that "subjective rankings are [statistically] significantly correlated with objective measures." As an illustrative example they note that "firms that complain [more] about electricity are doing so because they are experiencing more outages." The paper provides a valuable review of the underlying conceptual problem and many references to other similar efforts to test the reliability of subjective indicators.

An analogous exercise is presented in the recent World Bank report which gives estimates of the *Logistics Performance Index* (LPI) (*Connecting to Compete: 2010: Trade Logistics in the Global Economy*). The report compares the LPI with other indicators. The correlation coefficient with the World Economic Forum's *Global Enabling Trade Index* is 0.85. Components of the LPI that deal with border procedures are correlated with analogous ones from the World Bank's *Doing Business* dataset, and correlation of export and import time measures is about 0.5 - somewhat lower than for the broader overall measure, but still significant.

Appendix 4. Institutional Indicators for Comparator Countries

Dynamic East Asian Exporters

	Ease of Doing Business Rank	LPI Rank 2010	Regulatory Quality*	Rule of Law*	Control of Corruption*
Hong Kong, PRC	4	13	100	91	94
Indonesia	123	75	45	29	31
Malaysia	24	29	10	20	6
Philippines	133	44	60	65	63
Singapore	1	2	52	40	26
S. Korea	30	23	100	94	100
Taiwan, China	50	20	82	74	73
Thailand	15	35	60	54	43
Vietnam	91	53	32	42	25

Eastern Europe and CIS

	Ease of Doing Business Rank	LPI Rank 2010	Regulatory Quality*	Rule of Law*	Control of Corruption*
Albania	136	119	57	33	39
Armenia	39	111	62	43	35
Belarus	110	N/A	10	17	24
Bosnia	105	87	49	44	46
Bulgaria	46	63	73	51	52
Croatia	97	74	67	55	62
Czech Rep.	56	26	82	77	67
Estonia	17	43	92	85	79
Georgia	18	93	69	44	51
Hungary	45	52	88	76	73
Kosovo	N/A	N/A	54	30	30
Latvia	22	37	81	71	65
Lithuania	26	45	85	68	63
Macedonia	75	73	59	46	55
Moldova	92	104	48	41	31
Montenegro	81	121	52	53	48
Poland	74	30	74	65	68
Romania	48	59	68	54	57
Russia	106	94	31	20	16
Serbia	86	83	47	41	53
Slovak Rep.	32	38	85	67	69
Slovenia	55	57	75	82	80
Turkey	57	39	59	56	60

Ukraine	139	102	39	31	28

Sources: World Bank, *Doing Business Reports, Logistics Performance Ranking*, and *Governance Indicators*.