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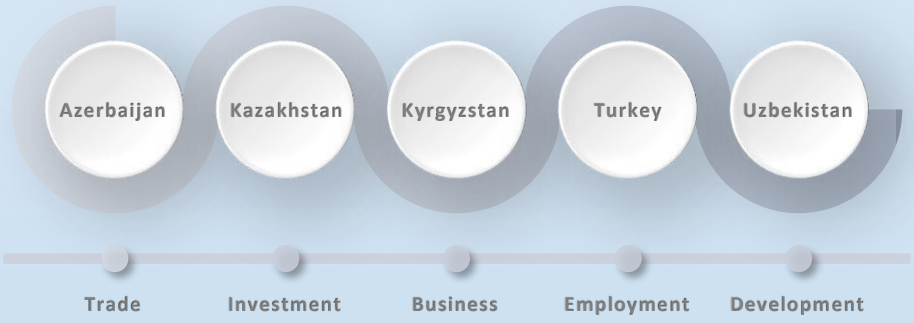
TRADE AND INVESTMENT RELATIONS AMONG THE TURKIC COUNCIL MEMBER STATES

Recent Trends and Prospects for Deepening Economic Relations



TRADE AND INVESTMENT RELATIONS AMONG THE TURKIC COUNCIL MEMBER STATES

Recent Trends and Prospects for Deepening Economic Relations

Prepared in cooperation between the Cooperation Council of Turkic Speaking States and the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC).

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Contents

Acronyms

ADB	Asian Development Bank
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
DAC	Development Assistance Committee
DB	Doing Business
DOTS	Direction of Trade Statistics
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECO	Economic Cooperation Organization
EEC	Eurasian Economic Commission
EPI	Export Potential Indicator
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GNI	Gross National Income
GSP	Generalized System of Preferences
GVC	Global Value Chain
HS	Harmonized System
ICT	Information and Communication Technology
ILO	International Labour Organisation
IMF	International Monetary Fund
IPR	Intellectual Property Rights
ITC	International Trade Centre
KILM	Key Indicators of Labour Market
LDCs	Least Developed Countries
LPI	Logistic Performance Index
MFN	Most Favoured Nation
NTM	Non-Tariff Measures
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OIC	Organisation of Islamic Cooperation
PPP	Purchasing Power Parity
R&D	Research and Development
RCA	Revealed Comparative Advantage
RTA	Regional Trade Agreement
SDG	Sustainable Development Goal
SEZ	Special Economic Zone
SME	Small and Medium-sized Enterprise
SPS	Sanitary and Phytosanitary Measures

TBT	Technical Barriers to Trade
TC	Turkic Council
TC-4	Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey
TC MS	Turkic Council Member States
TCI	Trade Complementarity Index
TII	Trade Intensity Index
TFI	Trade Facilitation Indicators
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNIDO	United Nations Industrial Development Organization
UNSD	United Nations Statistics Division
US	United States of America
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WEO	World Economic Outlook
WTO	World Trade Organization

Foreword

It is with great pleasure that I present this report, which provides a range of useful comparative statistics on the Turkic Council Member States' economies. The report enables direct comparison among the Member States and provides insights that can help analyze the main economic trends, identify issues, and shape future policy.

The Turkic Council was officially launched in 2009 by signing the "Nakhchivan Agreement" between Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey. Since then, the Member States have introduced major economic reforms and became increasingly interdependent in many areas. Enlarged by granting observer status to Hungary in 2018 and joining Uzbekistan as a full member in 2019, cooperation under the Turkic Council's umbrella has turned into an intensive and ambitious partnership, with clear long-term goals and readiness to deepen economic relations.

This report aims to keep economic cooperation high on the Turkic Council agenda and become a driver for a positive change in the Member States' economic relations by providing valuable inputs for the political elites, policymakers, analysts, and the general public.

The report explores economic trends in the Member States and examines what their economic relations look like today. The report also highlights many challenges and opportunities and delivers many ideas on how to improve economic ties. One of this report's advantages is the comparability between the national economies, which allows authorities to understand how their economies could further be developed, encouraging them to learn from each other's best practices under the Turkic Council's umbrella. Besides, the wide range of issues covered by the report makes it a practical manual for developing economic relations among the Member States.

We welcome the fact that the economic ties between the Member States are becoming more visible every year. However, the report's messages are very clear: The Member States has many things to do, to address several important issues highlighted by the findings, to keep the economic relations growing.

I would like to encourage the Turkic Council Member States to place this report's findings in their development priorities, accelerate the implementation of the necessary reforms, and provide a more sustainable framework for improving their economic relations. In this context, I want to emphasize that the Turkic Council will continue to invest its efforts in strengthening cooperation among the Member States and develop partnerships pertinent to economic development.

This report was developed with dedication and thanks to the skills and efforts of the SESRIC research team. I would like to acknowledge their contributions hoping that you will enjoy reading this report, but above all, benefit from its findings.

Acknowledgments

This report has been prepared in collaboration between Turkic Council and SESRIC. A core research team at the SESRIC comprising Kenan Bağcı, Cem Tintin and Erhan Türbedar have drafted the report. Chapter 1 on *Economic Growth and Foreign Economic Relations* is prepared by Erhan Türbedar. Kenan Bağcı wrote Chapter 2 on *Current Trends in Cross-Border Trade*, Chapter 3 on *Trade Policies and Barriers to Trade*, Chapter 4 on *Analysis of Intra-Regional Trade Potential*, and Chapter 9 on *Policy Issues for Creating and Maintaining a Strong Economic Cooperation*. Cem Tintin is author of Chapter 5 on *Current Trends in Investment* and Chapter 6 on *Analysis of Investment Climate and Major Impediments to Investment*. Kenan Bağcı and Cem Tintin wrote Chapter 7 titled *Uzbekistan: New Member, New Impetus.*

The first draft of the report was finished in September 2019, focusing on Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey, referred to as TC-4 throughout the report. After joining Uzbekistan as a full member of the Turkic Council in 2019, Chapter 7 is drafted as a dedicated section to this new Member State. The Member States reviewed the report in 2020 and made valuable contributions. Accordingly, in the capacity of the Advisor at Turkic Council, and following the suggestions of the Member States, Erhan Türbedar introduced necessary amendments. Moreover, Erhan Türbedar updated all figures and tables of the report using the most recent available data.

The Secretary General of Turkic Council, Baghdad Amreyev, the Deputy Secretary General of the Turkic Council, Ömer Kocaman, and Project Director at the Turkic Council, H. Özge Pan, provided major support and coordination during the preparation of the report.

Turkic Council acknowledges the crucial insights shared by senior authorities of the Member States. Council extends special thanks to the Director General of SESRIC, Nebil Dabur, for his support in preparing this report.

Executive Summary

- This study investigates the current trade and investment patterns in and among the Turkic Council Member States. It analyses the bottlenecks in promoting trade and investment and proposes alternative policy measures to enhance trade and investment among the Member States. The first six chapters cover Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey, while Chapter 7 is dedicated to Turkic Council's new Member State, Uzbekistan.
- The combined GDP of Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey (hereinafter TC-4) was worth $999 billion in 2019. It represented 2.35% of the world economy. Turkey dominates within the combined GDP of the TC-4, accounting for the above three-quarters of it in 2019. Real GDP growth figures for 2017-2019 continue to display stable growth momentum for the TC-4 economies.
- In 2019, Kazakhstan recorded the highest GDP per capita among the TC-4 countries, at $9,750. With a very close figure to Kazakhstan, $9,151 GDP per capita puts Turkey in second place, followed by Azerbaijan in third place ($4,814). According to the World Bank data, GDP per capita was significantly lower in Kyrgyzstan at $1,324.
- A fundamental weakness of the TC-4 countries is the low or meager share of manufacturing. From 1990 to 2018 share of manufacturing in GDP has significantly fallen in Azerbaijan, Kyrgyzstan, and Turkey. Agriculture's share in the TC-4 economies has progressively declined to less than 7% in Azerbaijan, Kazakhstan, and Turkey. However, agriculture's importance in the economic and social fabric of the TC-4 countries goes well beyond this indicator due to the food security dimension and many families being dependent on rural incomes.
- In Turkey, economic growth continues to be largely disconnected from employment growth. Despite real GDP growth, unemployment in Turkey reached 13.5% in 2019. In Azerbaijan and Kazakhstan, unemployment is stabilized at around 5%. With the expatriate working population's contribution, the labor situation has improved in Kyrgyzstan, where total unemployment was reduced to 6.3% in 2019.
- In 2019, 98% of the export basket of Azerbaijan and 90% of Kazakhstan's exports were primary products and resource-based products. In the same year, the share of medium-tech products in Turkey's export basket was 35%. In contrast, Kazakhstan and Kyrgyzstan's same data was at 6%, and for Azerbaijan 1% in 2019.
- External financing flows to the TC-4 countries have substantially decreased from $104.9 billion in 2013 to $25.9 billion in 2015. Net external financing flows to the TC-4 have remained only at $13.8 billion in 2018 and 2019.

- Remittance inflows to the TC-4 economies have reached $5 billion in 2019. However, this was a 12% decrease from 2018, when the amount was $5.7 billion. Remittance inflows were the largest external finance source for Kyrgyzstan in 2018, reaching a record high of near $2.7 billion.

International Trade among the TC MSs

- Total exports among the TC-4 countries exceeded $9.3 billion in 2012. Over the following four years, it repeatedly fell to reach near $5 billion in 2016. Since then, an upward trend has been observed in intra-TC-4 exports, which is recorded at above $9.5 billion in 2019. However, after reaching 8.3% in 2012, the share of total trade among TC-4 in the total trade volume of the TC-4 countries was steadily declining and reduced to 5.9% in 2019.
- Turkey and Kazakhstan accounted for around 90% of all intra-TC-4 exports until 2014. Azerbaijan and Kyrgyzstan were each accounting for about 4-6% over the same period. However, Azerbaijan expanded its trade relations with the other Member States after 2016. As of 2019, Azerbaijan accounted for 30% of intra-TC-4 exports, while Turkey and Kazakhstan's shares declined to 33% and 32%, respectively.
- Kyrgyzstan has the highest share of trade with the rest of the TC-4, with a value of 18.4% in 2019. It was followed by Azerbaijan (14.2%) and Kazakhstan (4.3%). Although Turkey has the largest share in intra-TC-4 trade, its share in total trade of the country in 2019 was only 1.3%. On average, intra-TC-4 trade has more significant importance in Azerbaijan's and Kyrgyzstan's trade but the lesser extent in Turkey's and Kazakhstan's trade.
- Bilateral trade relations of individual TC-4 countries show a high concentration of trade flows. A comparison of 2010 and 2019 indicates that Turkey has been the leading trade partner to Azerbaijan. Kyrgyzstan became a more important partner for Kazakhstan, diminishing the importance of Azerbaijan over the years. For Kyrgyzstan, Turkey's importance in its trade relations substantially increased, resulting in a fall in Kazakhstan's share. For Turkey, Kazakhstan remained its major trade partner. However, its share declined ten percentage points from 2010 to 2019, while Kyrgyzstan and Azerbaijan's share increased seven and three percentage points, respectively.
- At the sectoral level, manufactured goods had the highest share during the 2000s, and with a share of 26% in the 2010s, it became an even more important sector in trade relations among the TC-4 countries. However, the percentage of mineral fuels, lubricants and related materials (28.6%) became highest during the 2010s. Particularly Azerbaijan and Kazakhstan are rich in natural resources, and these resources constitute a significant share of their exports. The third important sector is machinery and transport equipment, whose share has declined from 17.2% in the 2000s to 12.6% in the 2010s.
- In terms of trade policies, in 2019, the average weighted Most Favoured Nation (MFN) tariff for all goods was 6.2% in Azerbaijan and Kyrgyzstan, 6.5% in Kazakhstan, and 7.7%

in Turkey. In preferential trade agreements, the grand average of the effectively applied tariffs was 2.9% in Kyrgyzstan, 3% in Kazakhstan, 4.8% in Azerbaijan, and 5.7% in Turkey.

- As part of the Eurasian Economic Union (EEU), Kazakhstan and Kyrgyzstan enjoy zero tariff rates in their trade with each other. Among TC-4 countries, Azerbaijan has free trade agreements with Kazakhstan and Kyrgyzstan. By the end of 2020, Turkey applied non-MFN tariffs to Azerbaijan, MFN tariffs to Kazakhstan, and preferential tariffs to Kyrgyzstan within the Generalized System of Preferences (GSP). It is expected for the signed preferential trade agreement between Turkey and Azerbaijan to enter into force in 2021.
- The most considerable trade costs are observed between Azerbaijan and Kyrgyzstan. In 2018, bilateral trade costs between Azerbaijan and Kyrgyzstan were estimated at 201% ad valorem, which means that an additional cost of near two times the original value of commodities were incurred in their shipment from producers to local customers. The second most costly trade relationship within the TC-4 group was trade costs between Azerbaijan and Kazakhstan, reaching 124% in 2018. Azerbaijan's trade costs with Turkey are at a considerably lower level, and as of 2018, it stands at 88%. The lowest trade costs are observed between Kazakhstan and Kyrgyzstan, at 75% ad valorem in 2018. Trade costs between Turkey and Kazakhstan and Turkey and Kyrgyzstan stood at near 113% in 2018.
- Due to higher protectionism and the perishable nature of agricultural sector products, these products' trade costs are higher than manufactured goods. Still, it is promising to observe a fall in trade costs in agricultural products in recent years. However, it is also quite worrisome to see rising costs of trade in manufacturing goods.
- Concerning trade facilitation, Turkey has the highest score with 1.56 in 2019, indicating that it made the most progress in facilitating trade, according to OECD Trade Facilitation Indicators. With an average score of 1.23, Azerbaijan shows a moderate performance in trade facilitation. Kyrgyzstan and Kazakhstan need to focus more on specific aspects of trade facilitation to improve their overall trade facilitation performance.
- There are significant gaps between what TC-4 countries could export and what they actually export. Azerbaijan has the largest untapped export potential with Turkey. In 2019, Azerbaijan could export more than $88 million worth of products to Turkey in addition to what is exported. Its untapped potential with Kazakhstan and Kyrgyzstan was relatively lower, with $21.8 million and $3.7 million, respectively.
- Kazakhstan also misses a significant export potential with Turkey. It could additionally export $577.6 million worth of products in 2019 if factors that prevent these potentials' utilization were removed. On the other hand, Kazakhstan almost fully utilized its export potentials with Azerbaijan and Kyrgyzstan in 2019, where there were only $34 million and $48.7 million untapped export potential, respectively. Kyrgyzstan has the lowest magnitude of untapped export potential, mainly due to the smaller size of the economy. However, it could export over $60 million worth of products more than what it actually exports to Kazakhstan, $21.4 million more to Turkey, and $4.6 million more to Azerbaijan.

- Turkey falls short of utilizing a significant amount of export potential with other TC-4 countries. In 2019, there was a gap of $569.4 million with Azerbaijan, $755.9 million with Kazakhstan, and $478.6 million with Kyrgyzstan between what is exported and what could be exported to these countries. In total, Turkey experienced more than $1.8 billion of untapped export potential with TC-4.

Investment Trends and Prospects among TC MCs

- The total value of FDI inflows to TC-4 went down from $136.6 billion in 2010-2014 to $105.9 billion in 2015-2019. A similar picture was seen in FDI outward flows that went down from $45.7 billion in 2010-2014 to $22.2 billion in 2015-2019. In 2019, TC-4 economies altogether attracted 0.9% of the total world FDI inflows and hosted 1% of the world FDI inward stocks. In 2019, inward FDI Stock as a Percentage of GDP value was 65.5% in Azerbaijan, 84.1% in Kazakhstan, and 66.3% in Kyrgyzstan. In the same year, this value was lowest in Turkey (21.6%), which could stem from the relatively larger GDP compared to the rest of TC-4 economies.

- A similar picture can also be seen concerning per capita FDI directed to TC-4 economies. As of 2019, Kazakhstan ($8,136) and Azerbaijan ($3,215) hosted the highest FDI inward stock in per capita terms among TC-4. The same value for Turkey was $2,238 and for Kyrgyzstan $841.

- The total number of announced greenfield FDI projects was the highest in Turkey over 2010-2019. In total, 1737 projects were reported by Turkey, and Kazakhstan followed it with 435 recorded projects in this period, according to the UNCTAD data. The number of Special Economic Zones played a significant role in attracting greenfield projects in these countries. Overall, the figures reveal that independent of how FDI figures are measured, it is difficult to conclude that TC-4 countries reached their potentials in terms of hosting and attracting foreign investors.

- According to Member States' official data reported to the IMF's Coordinated Direct Investment Survey, inward FDI flows among TC-4 countries increased almost fourfold from $545 million in 2012 to $2,130 million in 2015. Turkey and Azerbaijan showed the largest gains in regional FDI inflows over this period. However, available data points out to deceleration in intra-TC-4 investment in the period after 2015.

- In 2019, the total stock of intra-TC-4 FDI inflows amounted to near $13.5 billion. Azerbaijan led intra-regional FDI stock inflows by nearly $6.2 billion, followed by Turkey with over $6 billion. 91% of intra-regional inward FDI stock belongs to Turkey and Azerbaijan. The stock of intra-regional investment attracted by Kazakhstan amounted to $819 million in 2019. Kyrgyzstan's same value was $436 million, according to the IMF data.

- A higher volume of intra-TC-4 FDI implies the existence of more robust economic ties among them. According to universal and local datasets on TC-4 used in the report, the level of regional economic integration in terms of FDI reveals the significant untapped

potential that needs to be addressed. Finally, the analysis on sectoral concentration of investments in TC-4 provides some hints on how to scale up intra-TC investment.

- According to the World Bank's ease of doing business indicator, the business and investment climate has improved in all TC-4 countries over the 2016-2020 thanks to national efforts and business-environment related reforms. Kazakhstan improved its ease of doing business score the most, which went up from 70.5 in 2016 to 79.6 in 2020. In this regard, Azerbaijan closely followed Kazakhstan, where its average score increased from 67.7 in 2016 to 76.7 in 2020.

- TC-4 countries are, on average, well-connected with each other as well as with the rest of the world. Nevertheless, for international investors, connectivity and transportation networks should not only be well-developed but also should be cost and time-efficient. In this regard, Logistics Performance Index (LPI) scores of TC-4 countries revealed that they all need to exert more efforts to improve their transportation networks to increase connectivity, reduce transportation costs and time, and attract more investors.

- Investors like profit opportunities and dislike risks and uncertainties that could constitute a threat for their investment project or narrow down their maneuver areas, such as limiting profit transfers or currency exchange. Therefore, they use a series of risk evaluation tools to assess the potential countries to invest. According to the OECD's Risk Classification System, TC-4 countries obtained scores between 4 and 7 over 2005-2020 on a scale of 1 (the lowest risk) to 7 (the highest risk). In this picture, TC-4 countries should work together to reduce their country risk scores to provide a business environment where there are limited risks and uncertainties for investors.

- Overall, TC-4 has some similarities in terms of their subsectoral competitiveness for foreign affiliates. On the other hand, there are also some differences among their performance in terms of sectoral concentration and number of hosted foreign affiliates in various sub-sectors. These differences and similarities should be assessed carefully to identify existing investment gaps in specific subsectors. In this way, the investors from Turkic Council Member States could complement each other. Nevertheless, this requires developing a Turkic Council investment cooperation framework to guide and encourage investors into the Member States.

Enhancing Economic Cooperation

- As the fifth member of the Turkic Council, Uzbekistan has provided a new stimulus to regional economic cooperation and partnership endeavors through its vibrant economic structure. In terms of intra-regional trade, Uzbekistan makes a meaningful contribution to total intra-regional exports. However, measures should be taken to facilitate trade with Uzbekistan, as there are significant costs associated with burdensome trade procedures.

- There is significant untapped potential in terms of investments that need to be addressed by designing and implementing effective policies both at the national and regional levels.

The new reform agenda and strong leadership have helped Uzbekistan attract more investment from abroad. Yet, there is still a need for Uzbekistan to eliminate remaining investment and trade barriers, reduce country risks, and improve infrastructure and competitiveness to attract more FDI from the Member States and beyond.

- Progress has been made in developing transport infrastructure. However, more needs to be done in terms of filling the gaps and making the networks operational. A fragmented approach, lack of coordination, high logistics costs, and inefficiency are the main obstacles to seamless regional transport connectivity. Developing integrated intermodal transport systems at the national and regional levels, minimizing non-physical barriers to cross-border transport, developing robust commercial capabilities, and improving legal and regulatory frameworks will help achieve transport connectivity for deepening economic relations. The private sector's important role in both conceptualization and realization of transport projects should also be considered.

- Economies of some Member States depend on producing a limited set of products, reflecting the concentration of economic activities in few sectors. Diversification into multiple sectors and products reduces these risks and vulnerabilities. It expands the opportunities for higher competitiveness in global markets with a greater capacity to achieve long-run sustained growth. To achieve diversification through industrial development, establishing a strong collaboration at the regional level is recommended. Regional economic integration offers a vast market for manufactures, thus allowing economies of scale for national industries. This, in turn, creates incentives to specialize and trade in diversified products and improve production efficiency.

- The Member States need to facilitate trade among them by simple rules and procedures, operational flexibility, fair and consistent contract enforcement, standardization of documents and electronic data requirements. Implementing a single-window system should be promoted to facilitate trade, enabling international traders to submit regulatory documents at a single location and/or single entity. A fair, transparent, and predictable regulatory framework for investment is also critical in attracting a higher foreign investment volume.

- The Member States have dynamic economic structures, and they achieved significant economic transformation over the last two decades. Moreover, they offer great opportunities in various sectors that they are rich and complement each other's demands. They can activate the potential of renewable energy through alternative financing modalities. If properly planned and managed, international tourism could play a significant role in the Member States' economic development by promoting economic growth and creating jobs. To achieve greater economic integration in the agricultural sector, more concentration is needed to create value chains, which is typically spurred by new consumption patterns and new production and distribution systems.

CHAPTER

Economic Growth and Foreign Economic Relations

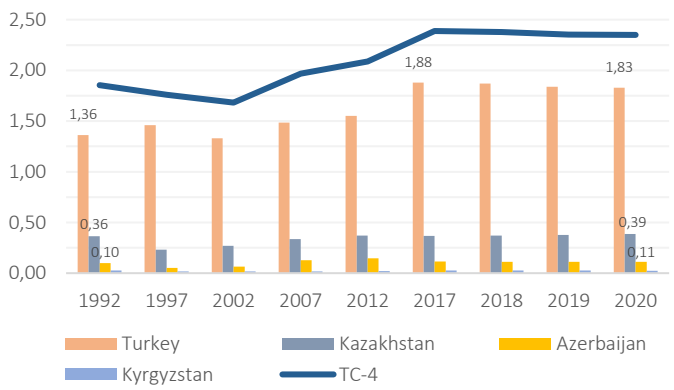
1 Economic Growth and Foreign Economic Relations

1.1 Production, Growth, and Employment

The combined GDP of Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey (TC-4) was worth $999 billion in 2019 and represented 2.35% of the world economy. GDP of the TC-4 averaged $1,113 billion from 2010 until 2018, reaching the highest point of $1,276 billion in 2013. In contrast to Turkey, whose share in the world economy until 2017 was growing steadily, since 1992, shares of Azerbaijan, Kazakhstan and Kyrgyzstan in the global economy did not undergo significant changes (Figure 1.1). In 2019, Turkey accounted for 1.84% of the world GDP in PPP, Kazakhstan 0.38%, Azerbaijan 0.11%, and Kyrgyzstan 0.03%.

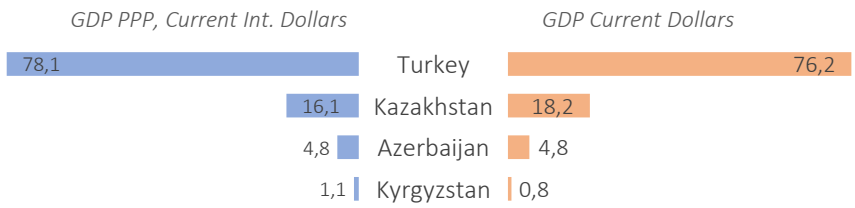
Turkey dominates within the combined GDP of the TC-4, accounting for above three quarters or $761 billion of it in 2019. Near 17% of the TC-4 aggregated GDP belongs to Kazakhstan ($182 billion), 4.6% to Azerbaijan ($48 billion), and 0.8% to Kyrgyzstan ($8.5 billion). When ranked by PPP adjusted GDP, the picture is more or less the same (Figure 1.2).

Figure 1.1: Share in the Total World GDP (PPP, %)



Source: IMF, World Economic Outlook, October 2020 update.
Note: IMF estimation for 2020.

Figure 1.2: Shares in the Combined GDP of the Turkic Council Member States (2019, percent)



Source: IMF, World Economic Outlook, October 2020 update.

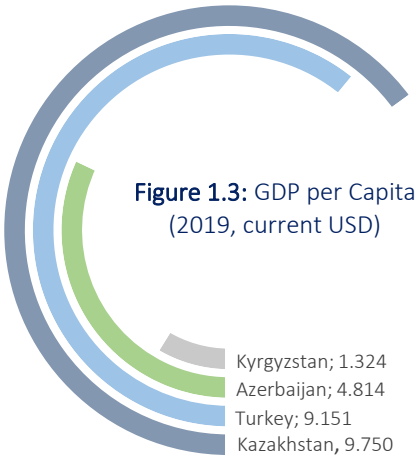


Figure 1.3: GDP per Capita (2019, current USD)

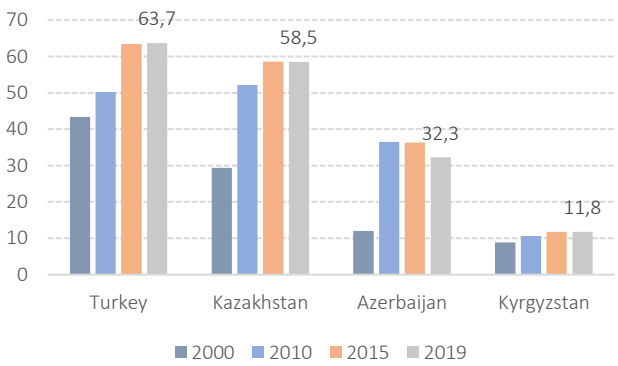
Source: IMF, World Economic Outlook, October 2020 update.

In 2019, Kazakhstan recorded the highest GDP per capita among the TC-4, at $9,750. With a close figure to Kazakhstan, $9,151 GDP per capita puts Turkey in the second place, followed by Azerbaijan in the third place ($4,814). According to the IMF data, GDP per capita is significantly lower in Kyrgyzstan at $1,324.

To better understand the level of prosperity of the TC-4, the index of GDP per capita in PPP shown in Figure 1.4 is expressed in relation to the European Union average (EU-27), set to equal 100. If the country's index is lower than 100, its GDP per capita is lower than the EU average and vice versa. In this regard, in 2019, PPP adjusted GDP per capita of the TC-4 ranged from 12% of the EU average in Kyrgyzstan to 64% of the EU average in Turkey. PPP adjusted GDP per capita is near 59% of the EU average in Kazakhstan and 32% of the EU average in Azerbaijan.

After 2013, the GDP values in current dollars have been negatively affected by the exchange rate fluctuations (Figure 1.5). In Azerbaijan's case, the main reason lies behind the insufficient diversification of the economy and its vulnerability to energy output volatility and prices. The eventual development of non-oil sectors would make the economy of Azerbaijan less vulnerable to commodity price volatility. Kazakhstan's economy also suffers from external shocks, such as lower oil prices and the slowdown of key trading partners, particularly Russia's recession.

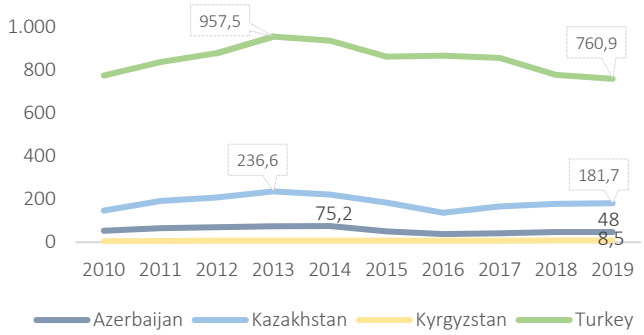
Figure 1.4: Index of Real GDP Per Capita (EU-27 = 100, PPP, constant 2017 international $, percent)



Source: IMF, World Economic Outlook database.
Notes: The Figure is using average GDP per Capita of European Union (U.K. excluded) as basis of comparison at 100.

When it comes to Turkey, this country's economic transformation and economic growth were sources of inspiration for many developing economies. Rapid urbanizations, opening up to the

Figure 1.5: Gross Domestic Product (Billions of current USD)



Source: IMF, World Economic Outlook database.

world economy in 1980, the introduction of structural and macroeconomic reforms including fiscal discipline in the 2000s, independence of central bank, constantly growing internal market (supported with young population), dynamic private sector and predictability in the Turkish economy have altogether contributed to steady growth of Turkish share in the world economy (see Figure 1.1). However, the structural current-account deficit and the high level of foreign currency denominated debt held by the private sector increase Turkey's external financing needs. Besides, current concerns over macroeconomic imbalances, a wave of tightening monetary policy in advanced economies, and existing geopolitical tensions all led to the rapid depreciation of the Turkish Lira, which caused the Turkish GDP in current dollars to lose around 21% of its value from 2013 to 2019 (Figure 1.5).

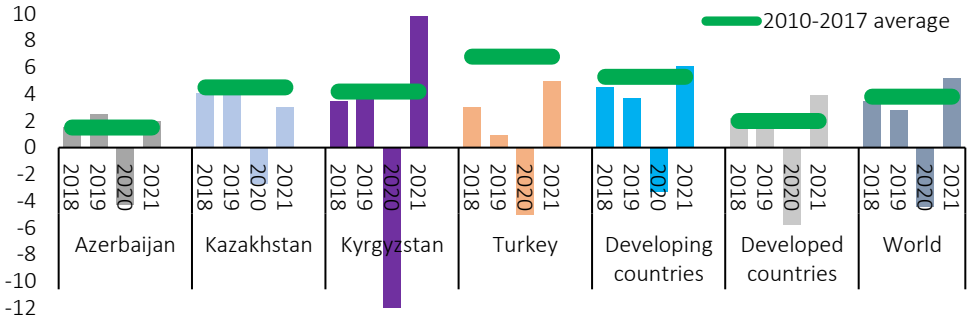
Currently, the world economy is shrinking, and substantial risks are arising. A synchronized global recovery that existed after 2016 lost its momentum due to the Covid-19 outbreak. According to the IMF estimates, negative growth rates are visible in developed and developing countries, causing a depression in the world's real GDP growth rate from 3.5% in 2018 to -4.4% in 2020. In the October 2020 update of World Economic Outlook, the IMF forecasts that the global economy will be on track to stabilize towards 2021 (see Figure 1.6).

Real GDP growth figures for the period from 2018 to 2019 have displayed stable growth momentum for the Turkic Council Member States. After the GDP decline in 2016 (-3.1%), Azerbaijan's economy escaped recession in 2017 with a symbolic growth rate of 0.2%. Supported by growth in the non-oil sector, output has continued to rise slowly in 2018, expanding the economy by 1.5%. Azerbaijan's economy grew faster in 2019 at 2.5%, driven by firm oil prices and continued private consumption recovery. However, Azerbaijan's average growth rates achieved in the period from 2010 to 2017 remain to be at comparatively lower levels (Figure 1.6). Moreover, the Covid-19 pandemic has shrunk the economy of Azerbaijan by -4.3% in 2020.

The economy of Kazakhstan seems strong. Driven by oil output expansion and favorable commodity prices, Kazakhstan's economy expanded at a rate of 4.1% in 2018 and 4.5% in 2019, faster than the 1.1% achieved in 2016. It is predicted a recession of Kazakhstan's economy by -2.7% in 2020.

Kyrgyzstan's economic climate remains relatively favorable, which grew by 3.5% in 2018 and 4.5% in 2019. However, Kyrgyzstan is expected to be among the most negatively affected countries by the Covid-19 pandemic. According to the IMF estimations, in 2020 GDP of Kyrgyzstan will face a negative growth rate of -12%.

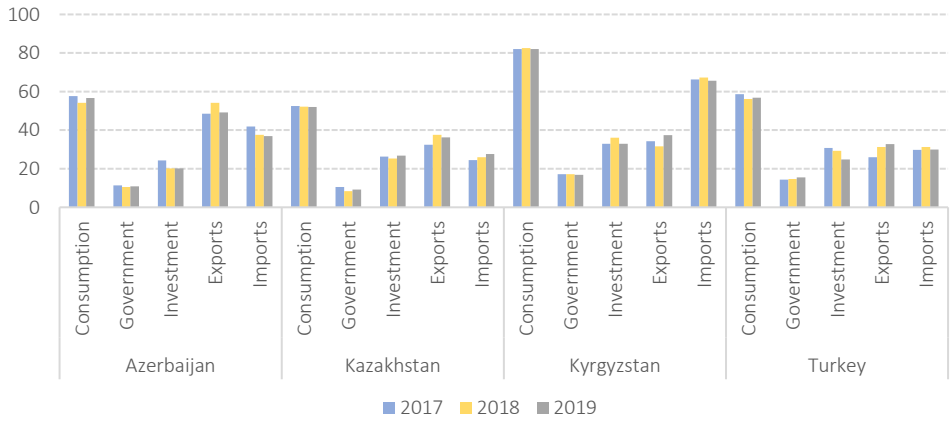
Figure 1.6: Real GDP Growth (Annual change, percent)



Source: IMF, World Economic Outlook, October 2020.
Notes: Forecast for 2020 ve 2021 (Developing countries: N = 154; Developed countries: N = 39; World: N = 193)

Real GDP growth of Turkey accelerated sharply in 2017, to 7.5% (from 3.3% in 2016) due to government stimulus measures, government credit guarantees to SMEs, improved export competitiveness, and significant public infrastructure projects. However, the Turkish Lira's rapid depreciation has exacerbated internal and external imbalances and caused Turkey's real GDP growth to decelerate sharply in 2019 to 0.9%. IMF expects Turkey to close 2020 with a negative growth rate of -5% (Figure 1.6).

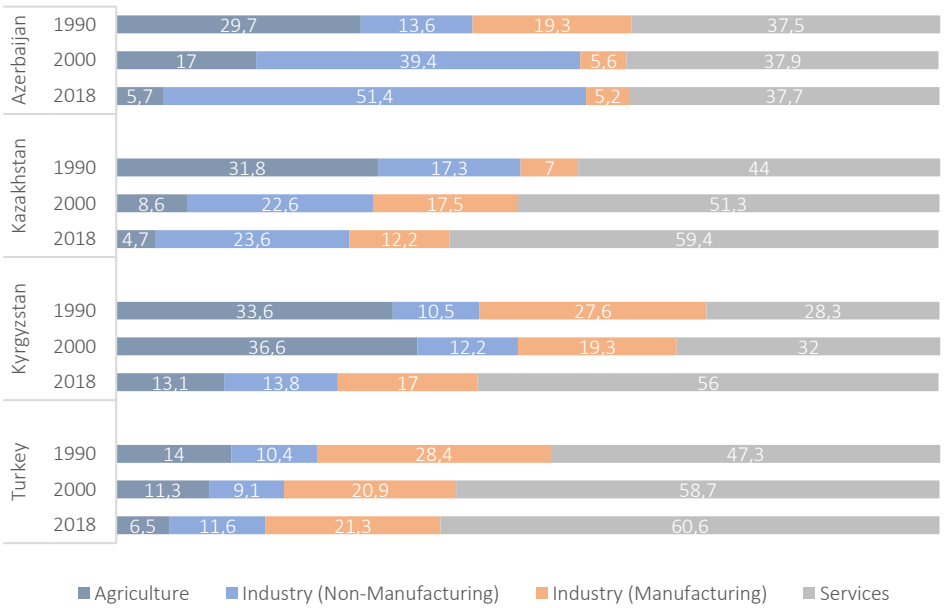
Figure 1.7: Structure of GDP (Demand, percent of GDP)



Source: World Bank, World Development Indicators.

From 2017 to 2019, the contribution of real net exports to GDP growth was significant in Azerbaijan, while somewhat faster growth of domestic investments and consumption provided a stimulus to Kyrgyzstan's economy. From 2018 to 2019, Azerbaijan, Kazakhstan, and Turkey have experienced a slight increase in government expenditure, and except for Kazakhstan, a slight decrease in imports. From 2018 to 2019, only in Kyrgyzstan import volumes were growing faster than those of exports (Figure 1.7). On the supply side, the critical weakness of the TC-4 is the low share of manufacturing. From 1990 to 2018 share of manufacturing in GDP has significantly fallen in Azerbaijan, Kyrgyzstan, and Turkey (Figure 1.8). The non-manufacturing industry (particularly the extraction industry) is proliferating in Azerbaijan. The reforms should promote innovation in manufacturing, to improve efficiency and make production more environmentally friendly.

Figure 1.8: Structure of GDP (Supply, percent of GDP)



Source: UNSD National Accounts Main Aggregates Database.

Agriculture's share in TC-4 economies has progressively declined to less than 7% in Azerbaijan, Kazakhstan, and Turkey. However, agriculture's importance in the economic and social fabric of the TC-4 goes well beyond this indicator due to the food security dimension and many families being dependent on rural incomes. For example, according to the UN estimations, in 2020, 24% of Turkey's population, 44% of Azerbaijan's population, 42% of Kazakhstan's population, and 63% of Kyrgyzstan's population were living in rural areas. As shown in Figure 1.8, the services sector accounts for most of the rise in the TC-4 economies' GDP growth.

Satellite images of Earth at night - often referred to as "night-lights"- are appealing instruments to measure countries' economic activity and economic growth. A large body of research shows that a country's night-lights' brightness is positively correlated with GDP growth. The more prosperity people have, the more likely they are to have lights on at night. Businesses will also stay open later, resulting in even more light.

Map 1.1: Turkic Council Member States at Night (2012, 2016)

Source: NASA Earth Observatory.

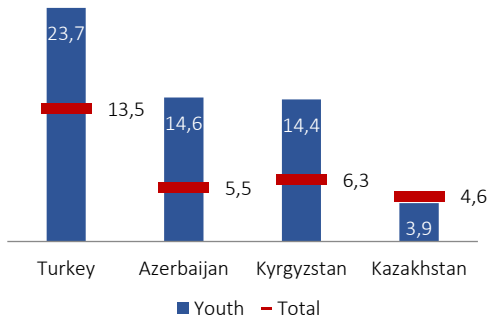
Map 1.1 shows the night-lights of the TC-4, as observed in 2012 and 2016, enabling for comparison of light sources in a given period. The first observation from these maps is the fact that Turkey is brighter lit by its cities, while the interiors of Kazakhstan and Kyrgyzstan remain dark and most probably sparsely populated. The second observation from Map 1.1 is that from 2012 to 2016, more lights are beginning to appear in many parts of Turkey and Azerbaijan, pointing out the more inclusive growth process in these countries. In contrast to the rest of the TC-4, the number of regional economic centers in Turkey has increased and became much more luminous. From 1992 to 2013, luminosity growth per square kilometer was the largest in Turkey (Table 1.1). Kyrgyzstan night-lights per square kilometer grew 13.7% in the same period. However, compared with Azerbaijan, Kazakhstan, and Turkey, actual pixel values per square kilometer are still the lowest in Kyrgyzstan (Table 1.1).

Table 1.1: Luminosity Growth per Square Kilometer

	1992 (area lit, km²)	2002 (area lit, km²)	2013 (area lit, km²)	1992-2002 growth (%)	2002-2013 growth (%)	1992-2013 growth (%)
Turkey	8.46	9.08	10.02	7.4	10.3	18.5
Kazakhstan	8.61	8.63	9.23	0.3	6.9	7.2
Azerbaijan	6.78	7.04	7.59	3.8	7.8	12.0
Kyrgyzstan	5.80	6.08	6.59	4.8	8.5	13.7

Source: Calculation based on dataset of Jeremy Proville et al. "Night-Time Lights: A Global, Long Term Look at Links to Socio-Economic Trends", *PLoS ONE* 12(3), 2017.

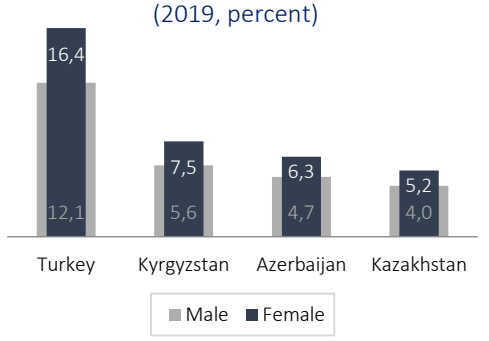
Figure 1.9: Unemployment (2019, percent)



Source: ILO modelled estimates.

In Turkey, economic growth continues to be largely disconnected from employment growth. Despite real GDP growth from 2012 to 2019, Turkey's unemployment continues to grow, reaching 13.5% in 2019 (Figure 1.9). In the same period, Azerbaijan and Kazakhstan were almost stabilized at around 5%. With 4,6% in 2019, Kazakhstan has reached its lowest unemployment rate in the last 25 years. The expatriate working population has contributed to improving Kyrgyzstan's labor situation, where total unemployment was reduced from 8.4% in 2012 to 6,3% in 2019. In Turkey, the employment growth is under the shadow of an increased number of people entering the labor market, thus paving the way for unemployment to remain at higher levels. Skills mismatch is another crucial factor behind the higher unemployment rates in Turkey. The ILO estimates that Azerbaijan and Kyrgyzstan's total unemployment rate will increase in 2020, slightly decrease in Turkey, and remain stable in Kazakhstan.

Figure 1.10: Unemployment by Gender (2019, percent)

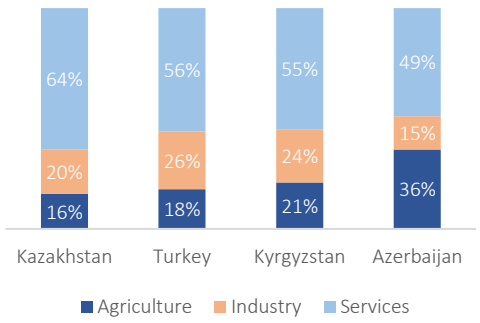


Source: ILO modelled estimates.

The lack of employment opportunities for youth (i.e., those between 15-24 years of age) remains another major challenge of the TC-4s, except Kazakhstan. The challenge is particularly acute in Turkey, where 23.7% of young people in the labor market remained without a job in 2019. In the same year, the youth unemployment rate in Azerbaijan was 14.6%, or almost 2.7 times higher than the total unemployment rate (Figure 1.9).

Differences in unemployment rates between women and men in the TC-4 economies are relatively small. Still, it is evident from Figure 1.10 that it is harder for women to find a job. In this regard, a worse situation is observed in Turkey, where women's unemployment rate for 2019 – at 16.4% – is 4.3 percentage points higher than the rate for men, according to the ILO modelled estimates.

Figure 1.11: Employment by Sector (2019)



Source: ILO modelled estimates.

Figure 1.11 shows data on the composition of employment by sector of economic activity. In 2019, the most significant share of TC-4 working-age persons engaged in any activity to produce goods or provide services were employed in the services sector. In Turkey, the services sector employed 64% of working-age persons. Between 20% to 26% of people were employed in the industry sector in Kazakhstan, Kyrgyzstan, and Turkey. Figure 1.11 indicates the relative importance of the agriculture sector in Kyrgyzstan, where 36% of working-age persons were employed in 2019.

In Turkey, real wage growth and labor productivity growth followed a declining trend between 2013 and 2018, despite an acceleration in economic growth. The situation is more critical in Azerbaijan, facing negative real wage growth and negative labor productivity growth from 2015 to 2018. Kazakhstan also experienced negative real wage growth rates in the 2015-2017 period. In Kyrgyzstan, real wage growth had increased from 3.1% in 2015 to 9.7% in 2016, then

Figure 1.12: Real Wage Growth (Annual change, percent)

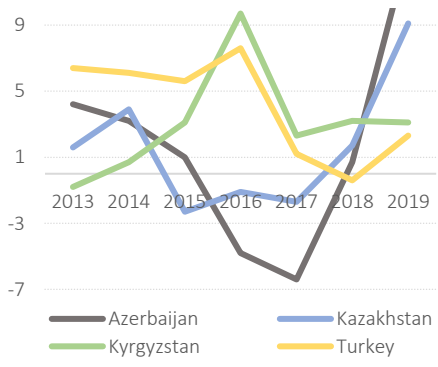
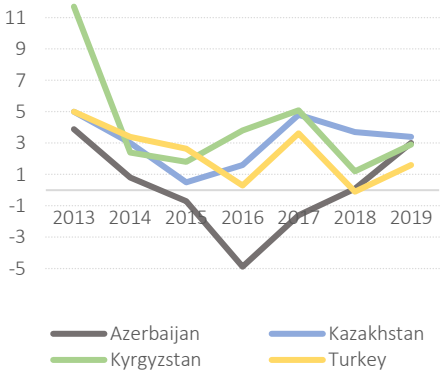


Figure 1.13: Real Labor Productivity Growth (Annual change, percent)



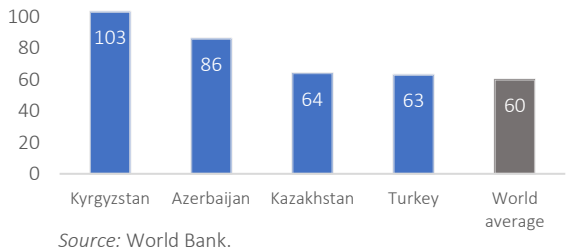
Source: ILO, *Global Wage Report 2020-21: Wages and Minimum Wages in the Time of COVID-19*, Geneva, International Labour Organization, 2018.
Note: Real labour productivity growth is calculated based on ILO modeled estimates on output per worker (GDP constant 2011 international $ in PPP).

declined to about 2.3% in 2017. Nevertheless, it is visible from the comparison between Figure 1.12 and Figure 1.13 that, on average, real wages in the TC-4 economies have increased more rapidly than labor productivity in the period from 2018 to 2019.

1.2 Foreign Trade in Goods and Services

One of the most important economic development factors is foreign trade. Over the past two decades, the TC-4 economies have benefited significantly from increased integration into the global economy. As shown in Figure 1.14, in 2019, all TC-4 economies had trade-to-GDP ratios over the world average. Smaller countries, in terms of size or population, generally have higher values in this indicator. They tend to specialize in a limited number of sectors and, to satisfy domestic demand, they need to import and export more goods and services than relatively self-sufficient larger countries. Trade represented 86% of Azerbaijan's GDP in 2019 (Figure 1.14) when the country recorded a $5.9 billion trade surplus. Moreover, the balance of trade in Azerbaijan averaged $8.4 billion from 2012 until 2019, with the highest $19.2 billion in 2012 (Figure 1.15). According to the State Statistics Committee, in 2019, Azerbaijan's foreign trade surplus totaled $5.97 billion, trade turnover amounted to $33.3 billion (7.6% increase compared to 2018), and the exports amounted to $19.6 billion. The share of the oil/gas sector in the top five export items of Azerbaijan was 90% in 2019, making the country highly vulnerable to global energy prices (Figure 1.16).

Figure 1.14: Total Trade as Percent of GDP (2019)



Source: World Bank.

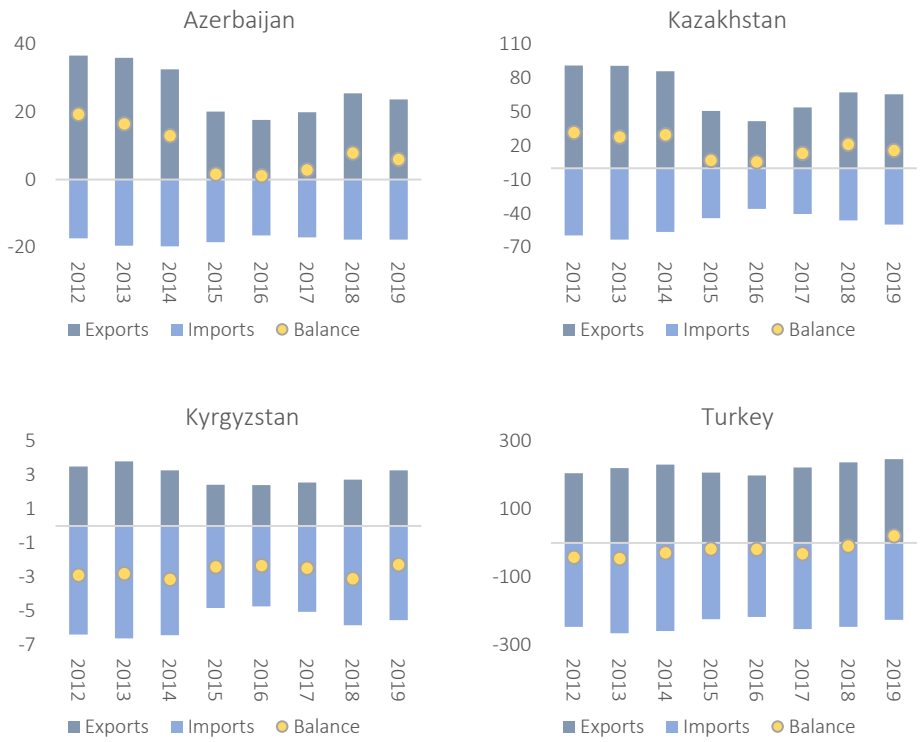
Kazakhstan is one of the biggest landlocked nations in the world. Strategically, however, Kazakhstan is located in Eurasia's heart at the intersection of transport and communication lines connecting China's and South Asia's large and fast-growing markets with Russia and Western Europe. Together with Kyrgyzstan, Kazakhstan is the member state of the Eurasian Economic Union (EAEU) - a limited customs union.

In 2019, the combined value of exports and imports of Kazakhstan was equal to 64% of GDP (Figure 1.14). In the same year, Kazakhstan exported $65.5 billion and imported $49.9 billion, resulting in a positive trade balance of $15.7 billion (Figure 1.15). From 2012 to 2016, Kazakhstan's exports have continuously decreased, recording values from $91 billion in 2012 to $41.5 billion in 2016. The share of the oil/gas sector in Kazakhstan's top five export items was near 64% in 2019 (Figure 1.16).

Kyrgyzstan had a total export of $3.3 billion and total imports of $5.6 billion, leading to a negative trade balance of $2.3 billion in 2019 (Figure 1.15). A reliance upon energy and value-added imports explains the significant trade deficit that exists over the years. The export in

2018 was led by gold, representing 36.2% of Kyrgyzstan's total exports, followed by precious metal ores, which accounted for 6.8% (Figure 1.16). A low level of product diversification and reliance upon natural resources makes Kyrgyzstan's economy susceptible to volatile

Figure 1.15: Total Trade Balance (Current $US, billion)

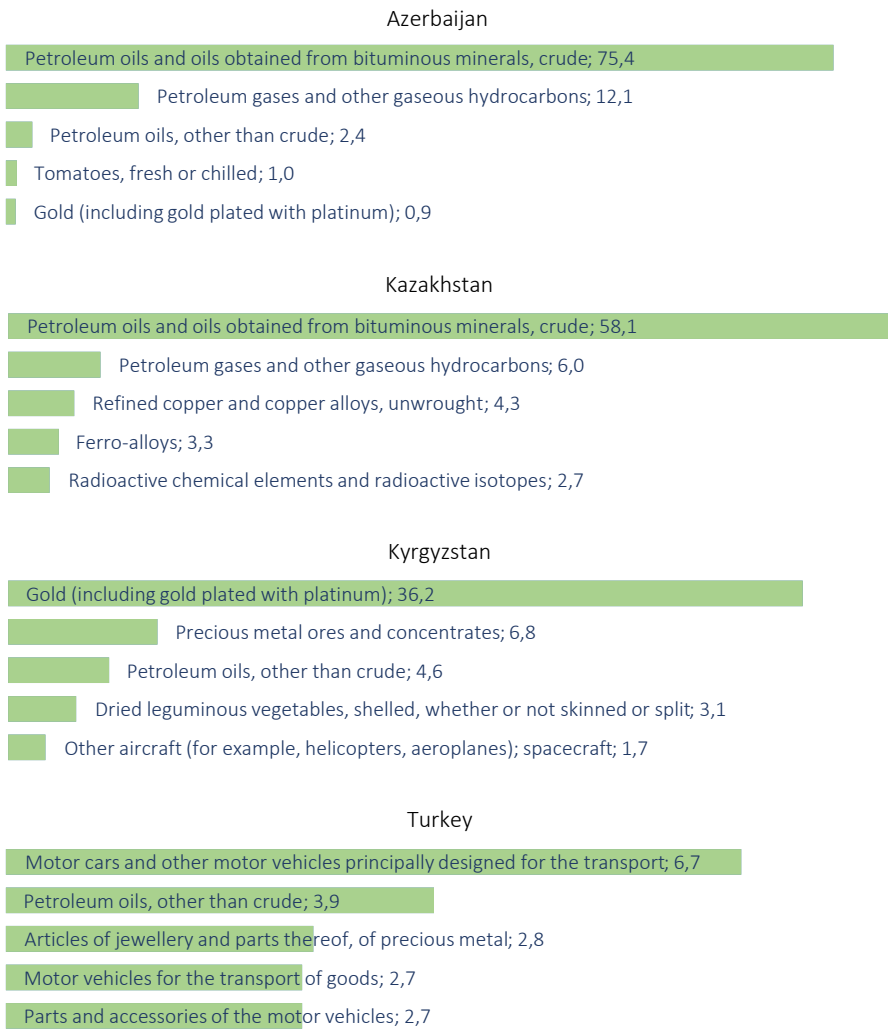


Source: UNCTADSTAT.

commodity prices.

Turkey's total foreign trade turnover in 2019 was $474.2 billion, making it the biggest trading nation among the TC-4 economies. Turkish exports rose by 3.8% in 2019 to hit $247.2 billion, while imports totaled $227 billion. After many years Turkey's trade demonstrated a surplus of $20.2 billion in 2019. In previous years, the Turkish trade deficit, in general, stemmed from strong domestic demand and rising global energy prices. Turkey is the only economy among Turkic countries whose top exports evolved from mainly labor-intensive and unprocessed agricultural products such as nuts, cotton, and tobacco in 1980 to mid-tech goods such as automobiles, white goods, and mechanical machinery by 2019. Furthermore, Turkey's export basket also diversified during this period. The top five products decreased from 51% to 19% in the same period (Figure 1.16).

Figure 1.16: Top Five Export Items (2019, percent)



Source: UN DESA, 2019 International Trade Statistics Yearbook, Volume 1, Department of Economic and Social Affairs of the United Nations Secretariat, 2020.
Note: 2018 data for Kyrgyzstan.

Table 1.2 illustrates that the EU Member States, China, and Russia are among the TC-4 economies' main trading partners. In 2019, Russia was the number one partner for Azerbaijan, Kazakhstan, and Turkey imports. China was the most significant import partner of Kyrgyzstan and the second-largest import destination for Kazakhstan and Turkey. On the export side, in the same year, European markets dominated as a destination for exports of the TC-4. In this context, the TC-4 economies remain highly reliant on the growth trends in the EU Member States, China, and Russia.

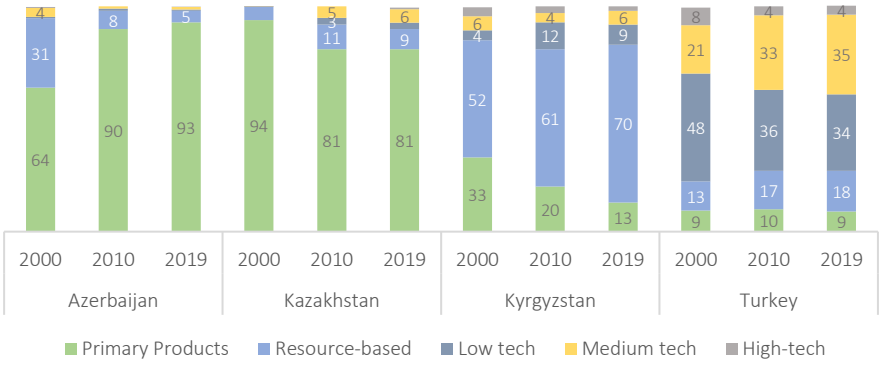
Table 1.2: Top Five Export and Import Partners (2019)

Top Five Export Partners		Top Five Import Partners
Share		Share
Italy (29%), Turkey (15%), Israel (7%), India (5%), Germany (5%)	Azerbaijan	*Russia (17%), Turkey (12%), China, P.R.: Mainland (10%), Switzerland (9%) United States (6%)*
Italy (15%), China, P.R.: Mainland (14%), Russia (10%), Netherlands (8%), France (6%)	Kazakhstan	*Russia (37%), China, P.R.: Mainland (17%), South Korea (9%), Italy (4%), Germany (4%)*
United Kingdom (42%), Kazakhstan (17%), Russia (14%), Uzbekistan (7%), Turkey (5%)	Kyrgyzstan	*China, P.R.: Mainland (35%), Russia (28%), Kazakhstan (12%), Turkey (5%), Uzbekistan (4%)*
Germany (9%), United Kingdom (6%), Iraq (6%), Italy (5%), United States (5%)	Turkey	*Russia (11%), China, P.R.: Mainland (9%), United States (6%), Italy (4%)*

Source: IMF DOTS

While the assignment of products to specific categories is not uncontroversial, analyzing how a country's export basket has changed over a span of years may give insight into its economic development pattern. As can be followed from Figure 1.17, in 2019, 98% of the export basket of Azerbaijan, 90% of Kazakhstan's exports, and 83% of Kyrgyzstan's exports were primary products and resource-based products. In the same year, the share of medium-tech products in Turkey's export basket was 35%. In contrast, the same data for Kazakhstan, Kyrgyzstan, and Azerbaijan remained at 6%, 6%, and 1%, respectively. From this, it can be concluded that the TC-4 countries are not among innovative economies except Turkey.

Figure 1.17: Technological Classification of Export (percent)



Source: WITS, World Bank.

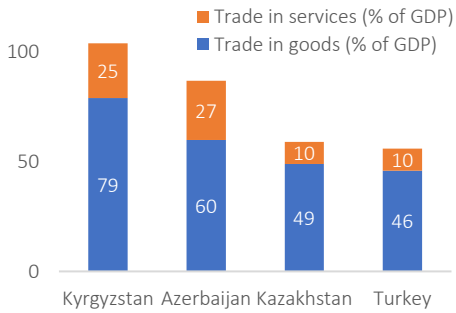
International Trade in Services

Services sectors play a growing role in global trade with the increasing tradability of services driven by advancements in information and communications technology (ICT) and the related growth of global value chains. Especially, improvements in ICT continue to reduce the need for proximity between consumer and producer and allow greater use of outsourcing and offshoring of economic activities. Accordingly, services are becoming more productive, more tradable, and more innovation-driven.

Services activities include transport, tourism, financial services, use of intellectual property, telecommunications and information services, government services, maintenance, and other professional services from accounting to legal services.

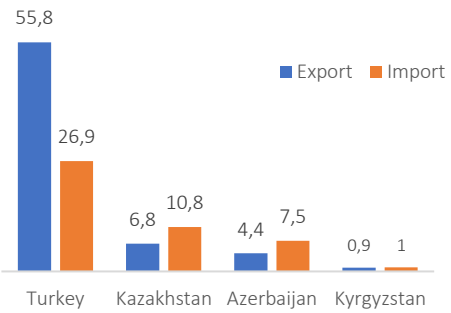
As services account for between 49%-64% of employment (Figure 1.11) and between 38%-61% of GDP (Figure 1.8) of TC-4 countries, trade in services, both as exports and as inputs to other exported products, can have a broad impact across the TC-4 economies. Trade in services (the sum of service exports and imports) represents 27% of the GDP of Azerbaijan, 25% of Kyrgyzstan's GDP, and 10% of Kazakhstan's and Turkey's GDP (Figure 1.18). The relatively minor role of services in international trade of TC-4 countries contrasts with the contribution of services to their domestic economies. As in trade in goods, government barriers prevent trade in services from expanding to its full potential. In many cases, the impediments are government regulations or rules that appear legitimate. However, they may intentionally or unintentionally discriminate against foreign providers.

Figure 1.18: Trade as Percent of GDP, (Average of 2015-2019)



Source: World Bank data.

Figure 1.19: Trade in Services (Average of 2015-2019, billion $US)



Source: WTO data.

As shown in Figure 1.19, from 2015 to 2019, Turkey was TC-4's leading services exporter and importer, with a significant trade surplus. In the same period, the overall balance in trade in service remained negative in other economies, particularly Azerbaijan and Kazakhstan.

The sectoral distribution of services export reveals that TC-4 economies generally export travel and transport services (Table 1.3). These two sectors account for more than 83% of the TC-4 average exports from 2015 to 2019. Other services activities usually account for negligible shares of exports. Exports in more sophisticated and technology-intensive sectors such as telecommunication, computer, information, intellectual property, finance, and insurance are relatively low.

Table 1.3: Exports and Imports of Services by Sector (Average of 2015-2019)

Export of services

	Azerbaijan	Kazakhstan	Kyrgyzstan	Turkey
Travel	56,8%	30,5%	53,5%	44,0%
Transport	26,9%	53,8%	22,8%	39,9%
Government	0,6%	3,7%	1,0%	1,5%
Telecom	1,7%	1,9%	4,0%	2,3%
Other business services	10,5%	6,6%	7,4%	5,3%
Other services	3,5%	3,4%	11,3%	7,0%

Import of Services

	Azerbaijan	Kazakhstan	Kyrgyzstan	Turkey
Travel	31,40%	24,60%	37,00%	17,60%
Transport	15,90%	17,90%	44,80%	27,60%
Government	1,10%	1,40%	1,40%	4,40%
Telecom	1,40%	3,20%	2,50%	8,00%
Other business services	16,40%	40,10%	4,60%	16,80%
Other services	33,80%	12,80%	9,70%	25,60%

Source: WTO data.

Concerning imports of services, travel and transport sectors continue to be the significant import sectors. However, their share is not as high as in the case of exports. On average, they account for around 45% of the TC-4 economies (Table 1.3). More than 30% of imports made by Azerbaijan are related to the construction sector. 40% of imports by Kazakhstan are related to other business services, which include (i) professional and management consulting services, (ii) technical, trade-related, and other business services, and (iii) research and development (R&D) services. Insurance and pensions, financial services, charges paid for the use of intellectual property, and telecommunication and information-related services collectively account for more than 27% of Turkey's total service imports.

It is essential to identify areas for bilateral trade potentials and complementarities in services trade to increase the Member States' overall trade. However, existing databases on trade in services does not provide enough data on bilateral trade.

Overall, services are the fastest-growing sector of the global economy. Trade in services has grown faster than in goods over the past decade. Services constitute the largest share of global value-added, increasing global exports, and more than half of global employment. Moreover, services play a crucial role in producing goods and supporting productivity and competitiveness in other sectors. Services account for major tasks performed and exchanged in global supply chains. In many cases, it is not easy to separate manufacturing activities from services.

There is also a transformation within the services sector. While the shares of traditional service exports, including tourism and transport, are falling, exports of modern and more technology-intensive services, particularly those related to ICT services, are increasing. This transformation creates direct and indirect employment opportunities, especially for youth. Many countries worldwide, including developed and developing countries, prioritize expanding exports of services in their trade and development strategies.

There are, however, significant challenges faced by developing countries, including TC-4, in utilizing the potential of the trade in services in development. Lack of human, regulatory, and institutional capacity hinders exporters from exporting, producers from using imported services inputs, and policymakers from effectively regulating and developing services sectors.

Table 1.4: Exports and Imports of Services at Sectoral Level (Million $US, average of 2015-2019)

	TOT	GRS	TRP	TRV	CNS	INS	FIN	IP	TEL	OBS	PCR	GOV
Exports (Values and Shares)												
AZE	**4,39**	71	1,183	2,492	41	19	7	-	73	461	15	28
	100%	*1.6%*	*26.9%*	*56.8%*	*0.9%*	*0.4%*	*0.2%*	*0.0%*	*1.7%*	*10.5%*	*0.3%*	*0.6%*
KAZ	**6,77**	94	3,646	2,069	25	79	32	1	127	446	1	251
	100%	*1.4%*	*53.8%*	*30.5%*	*0.4%*	*1.2%*	*0.5%*	*0.0%*	*1.9%*	*6.6%*	*0.0%*	*3.7%*
KGZ	**902**	-	206	483	36	0	13	1	36	67	51	9
	100%	*0.0%*	*22.8%*	*53.5%*	*4.0%*	*0.0%*	*1.5%*	*0.2%*	*4.0%*	*7.4%*	*5.7%*	*1.0%*
TUR	**55,8**	1,309	22,31	24,58	546	1,248	582	94	1,261	2,949	146	824
	100%	*2.3%*	*39.9%*	*44.0%*	*1.0%*	*2.2%*	*1.0%*	*0.2%*	*2.3%*	*5.3%*	*0.3%*	*1.5%*
Imports (Values and Shares)												
AZE	**7,48**	71	1,191	2,348	2,269	139	33	-	105	1,222	17	84
	100%	*0.9%*	*15.9%*	*31.4%*	*30.3%*	*1.9%*	*0.4%*	*0.0%*	*1.4%*	*16.3%*	*0.2%*	*1.1%*
KAZ	**10,8**	488	1,943	2,665	407	45	239	140	344	4,352	73	151
	100%	*4.5%*	*17.9%*	*24.6%*	*3.8%*	*0.4%*	*2.2%*	*1.3%*	*3.2%*	*40.1%*	*0.7%*	*1.4%*
KGZ	**991**	4	445	366	14	7	18	6	24	45	47	14
	100%	*0.4%*	*44.9%*	*37.0%*	*1.5%*	*0.7%*	*1.9%*	*0.6%*	*2.5%*	*4.6%*	*4.7%*	*1.4%*
TUR	**26,9**	1,351	7,426	4,736	128	2,22	1,208	1,819	2,138	4,521	146	1,192
	100%	*5.0%*	*27.6%*	*17.6%*	*0.5%*	*8.3%*	*4.5%*	*6.8%*	*8.0%*	*16.8%*	*0.5%*	*4.4%*

Source: Author's calculations based on WTO database. TOT: Total; GRS: Goods related services; TRP: Transport; TRV: Travel; CNS: Construction; INS: Insurance and Pensions; FIN: Financial; IP: Charges for the use of intellectual property; TEL: Telecommunications, computer and information; OBS: Other business services; PCR: Personal, cultural, and recreational services; GOV: Government services.

It is observed that TC-4 economies fail to diversify their export base and increase their global trade share in services. It would be advisable for TC-4 economies to focus on sectors where

they have a comparative advantage and become more competitive in these areas. They could quickly identify the complementarities based on their comparative advantages and improve their bilateral trade relations. Massive imports of services in construction by Azerbaijan, for example, presents essential opportunities for Turkish construction firms, which are highly competitive (Table 1.4).

Given the importance of the services sector in growth, employment, and productivity, it is essential to address barriers to regional trade in services, prohibiting foreign providers, limiting foreign ownership and personnel, and imposing discrimination in qualification and licensing requirements. Turkic Council countries could also consider signing a regional trade agreement in services to overcome such barriers and improve trade relations in the services sector. An increasing number of regional trade agreements include a services component and regional integration of service economies. Advancements in ICT provide significant opportunities for the Member States to participate in the global trade network in services, further promoting foreign investment, knowledge transfer, and human capital development. Developing an efficient and competitive services economy and the trade in services in these and other sectors could significantly improve the outlook for TC-4 economies.

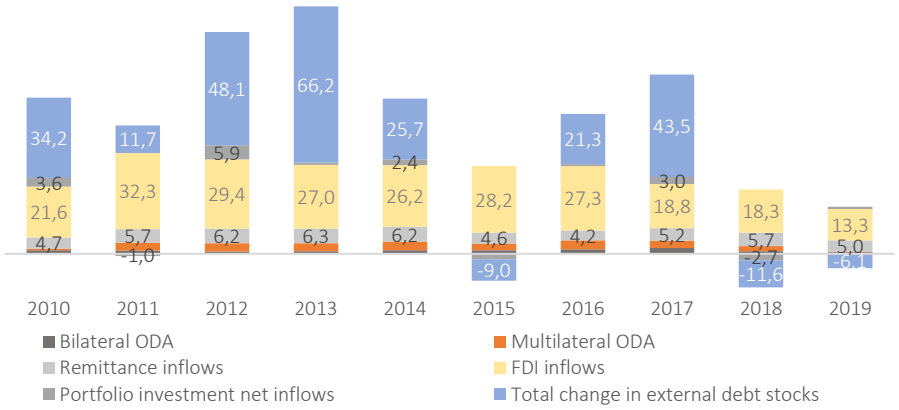
1.3 External Financing Flows for Development

The growing needs of countries are seldom accompanied by the resources that are necessary to meet them. Particularly in the developing world, leaders repeatedly point to the lack of financing as one of the primary barriers to long-term development. Inadequate capacities also challenge developing countries. In most cases, they need help for building local capabilities, institutions, expertise, and human resources to contribute to national development priorities. Consequently, governments are searching for new ways to finance their development needs because all finance sources -public and private, domestic, and international- have an essential role in funding the new investments across sectors.

International development cooperation has always played an essential role in supporting and boosting economic development. Conventional practice has been to treat development cooperation narrowly as the Official Development Assistance (ODA) provided by the OECD's Development Assistance Committee (DAC) countries. But given the growing gap between the demand for resources in developing countries and the flow of resources from provider countries, foreign aid is not enough. Therefore, mobilizing additional resources for development and increasing existing resources' effectiveness has become more pertinent than ever. As shown in Figure 1.20, international actors, both public and private, contribute substantive amounts of cross-border finance to the TC-4 economies.

External financing flows to the TC-4 have substantially decreased from $104.9 billion in 2013 to $25.9 billion in 2015. Compared to 2015, the volume of external finance available to the TC-4 economies increased to $76 billion in 2017. However, net external financing flows to the TC-4 have remained only at $13.8 billion in 2018 and 2019 (Figure 1.20).

Figure 1.20: External Financing Flows to the TC-4 by Sources (Current prices, billion USD)



Source: Author's calculations based on OECD "Creditor Reporting System" database for official bilateral and multilateral gross disbursements flows (Bilateral ODA flows are calculated based on 29 DAC countries and 20 Non-DAC countries that are reporting to the OECD); World Bank "Migration and Remittances Data" for remittances; UNCTADSTAT data on FDI; IMF "Balance of Payments Database" for portfolio investments; and World Bank data for external debt.
Note: TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey. 2019 Preliminary data for bilateral and multilateral ODA (ODA: Official Development Assistance).

Figure 1.20 witness the change in foreign aid's global landscape, where increased volumes of foreign direct investments (FDIs), cross-border remittances, loans, and other commercial interactions have reduced the significance of foreign aid (ODA) in relative terms. At $748,4 million in 2019, the total of bilateral and multilateral ODA flows to the TC-4 represents a small proportion of the external financial flows. While the proportion of total ODA declined to around 5% of total external finance transfers to the TC-4 in 2019, it provides critical inputs for Kyrgyzstan's economy. According to the World Bank data, in 2018, net ODA received as a percent of central government expense accounted for 24.2% in Kyrgyzstan, 1% in Azerbaijan, 0.6% in Turkey, and 0.3% in Kazakhstan.

It is interesting to note that in 2018, 74% of the total bilateral and multilateral ODA flows to the TC-4 has gone to Turkey. In general, ODA flows to Turkey were directed to Syrian refugees. Still, present ODA figures show that Turkey enjoys the status of both ODA provider and ODA recipient country. According to the OECD data, Turkey has provided $8.4 billion (gross disbursements) of ODA in 2018 in current USD, and again, most of this amount was spent on the refugees in Turkey. In the same year, Kazakhstan has provided $33.4 million and Azerbaijan $6.6 million of foreign aid to other developing countries.

As is shown in Table 1.5, remittance inflows to the TC-4 economies - money or other assets that migrants send to individuals in their home countries - have amounted $5 billion in 2019. However, this was a 12% decrease from 2018, when the amount was $5.7 billion. It should be noted that remittance inflows were the largest source of external finance for Kyrgyzstan in

2018, reaching a record high of near $2.7 billion (Figure 1.5). The World Bank has estimated that due to limited economic opportunities, in 2017, near 13% of the population (782,000 people) of Kyrgyzstan was working abroad. The money labor migrants sent back home to support their families in 2017 amounted to nearly one-third (32%) of Kyrgyzstan's GDP - one of the world's highest rates.

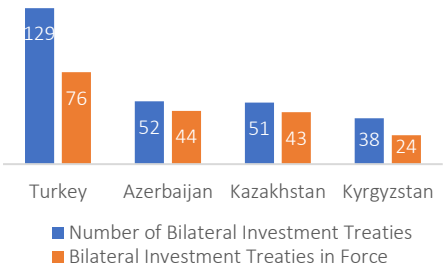
Table 1.5: External Financing Flows by Countries (2018, current prices, million $US)

	Azerbaijan	Kazakhstan	Kyrgyzstan	Turkey
Bilateral ODA	184,5	107,9	321,1	524,8
Multilateral ODA	47,5	22,1	193,3	1952,3
Remittance inflows	1226	618	2689	1122
FDI inflows	1403,0	3756,8	139,3	12981,0
Portfolio investment net inflows	0,0	-1520,0	0,0	-1131,0
Total change in external debt stocks	910,1	-1969,9	39,9	-10588,9

Source: Same sources that are explained in Figure 1.20.

FDIs remains to be a critical external source of finance for the TC-4 economies. Compared to portfolio investments, FDIs also provide a more stable stream. In 2018, FDIs had the highest share within the total external finance sources in Azerbaijan and Kazakhstan, and Turkey (Table 1.5). There appears to be awareness among the governments of the TC-4, particularly in Turkey, that entering into binding international investment agreements is essential for the attraction of FDIs and stimulating growth (Figure 1.21).

Figure 1.21: Number of Concluded Bilateral Investment Treaties (as of November 2020)



Source: UNCTAD, Investment Policy Hub.

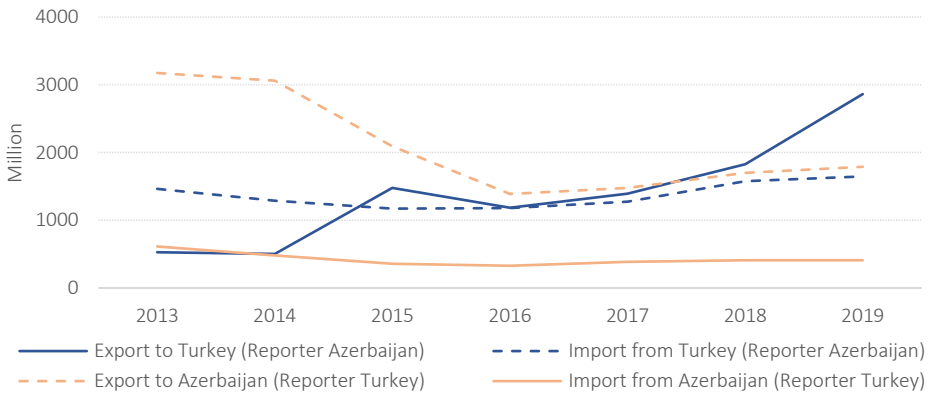
In contrast to remittances and FDIs, portfolio investments and external debt flow appear to be more vulnerable to global conditions, particularly global interest rates (Figure 1.21). However, the increase in external debt flows to Azerbaijan and Kyrgyzstan is evident for 2018, which calls on the governments to address the challenges linked to debt sustainability to prevent negative impact on long-term development.

1.4 Note on Asymmetries in Trade Statistics

Correctly understanding intra-regional trade patterns necessitates high quality, consistent, and harmonized statistics on international trade. Currently available trade statistics, however, fall short of this standard. In theory, since exports of country A need to be imports of country B, the value of the trade flow reported by A as exports to B should be equal to the imports reported by B from A. This issue is referred to as mirror statistics. However, in many cases, mirror statistics' discrepancies may be observed, referred to as bilateral trade asymmetries. It should be noted that it is even more challenging to measure trade in services than the trade in goods.

Figure 1.22 provides an example of asymmetries in trade statistics between Azerbaijan and Turkey. Blue lines represent data supplied by the State Statistical Committee of the Republic of Azerbaijan, and orange lines are data from the Turkish Statistical Institute. In theory, dashed lines on one hand and full lines on another should overlap. In other words, the exports of Azerbaijan to Turkey should mirror Turkey's imports from Azerbaijan and vice versa. Although from 2016 to 2019, exports to Azerbaijan reported by Turkey tend to converge with imports from Turkey reported by Azerbaijan, huge asymmetry is evident in the opposite direction. For example, in 2019, export to Turkey reported by Azerbaijan was near $2,5 billion higher from Turkey's data reported as an import from Azerbaijan (Figure 1.22). A detailed look into the commodities subject to trade shows that the main difference in these data between Azerbaijan and Turkey arises from reported values on mineral fuels, lubricants and related materials. Other significant asymmetries in trade statistics (above $1 million) between Azerbaijan and other Turkic Council Member States are presented in Table 1.6.

Figure 1.22: Trade between Azerbaijan and Turkey According to Official National Statistics (million $US)



Source: State Statistical Committee of the Republic of Azerbaijan for data reported by Azerbaijan and Turkish Statistical Institute for data reported by Turkey.
Note: Reporter is the country which reports the trade data.

Table 1.6: Examples of Large Trade Asymmetries (Reported Imports and Mirror Exports) by Product (2019, million $US)

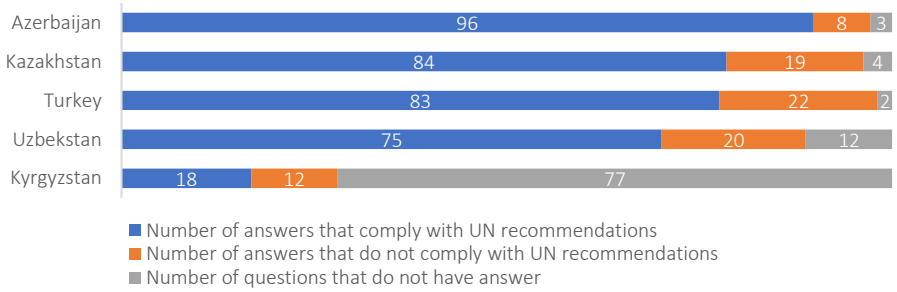
Reporter	Partner	Commodity	Reported Exports (A)	Mirror Imports (B)	(A) - (B)
Azerbaijan	Turkey	Crude materials, inedible, except fuels	112,72	129,48	-16,757
Azerbaijan	Uzbekistan	Crude materials, inedible, except fuels	17,27	7,04	10,229
Azerbaijan	Turkey	Mineral fuels, lubricants and related materials	2464,56	24,38	2440,177
Azerbaijan	Turkey	Chemicals	141,22	117,39	23,832
Azerbaijan	Uzbekistan	Chemicals	6,42	8,52	-2,093
Azerbaijan	Turkey	Manufact goods classified chiefly by material	133,01	123,63	9,388
Azerbaijan	Kazakhstan	Machinery and transport equipment	13,80	9,91	3,898
Azerbaijan	Uzbekistan	Machinery and transport equipment	2,27	1,03	1,231

Source: UN Comtrade.
Note: Reported Exports – Export of commodities reported by Azerbaijan; Mirror Imports: Values reported by partner countries to which the Azerbaijan commodities were imported.

These asymmetries in trade statistics arise due to many reasons. The United Nations Statistical Commission (UNSC), the highest global decision-making body in the field of statistics, has been discussing for years the existence of inconsistencies in the data due to asymmetries. There are two general approaches used to calculate international trade in goods. The first approach is concerned with data on physical movements of goods between countries or through special economic zones, which are defined by the "International Merchandise Trade Statistics: Concepts and Definitions 2010" (IMTS Manual). Customs records are traditionally the primary source of IMTS for both imports and exports.

National statistics agencies are expected to compile the trade in goods statistics according to the definitions and guidance IMTS Manual. However, some countries with more advanced statistical systems exploit other data sources, such as enterprise surveys and administrative records associated with taxation. The last survey conducted by the UN in 2006 on national compilation and dissemination practices in trade in goods statistics reveals that the Turkic Council Member States does not entirely comply with UN recommendations (Figure 1.23).

Figure 1.23: International Merchandise Trade Statistics
National Compilation and Reporting Practices (2006 Survey Results)



Source: UN Statistics Division, https://unstats.un.org/unsd/tradereport/default.asp

The second approach in calculating trade in goods relies on macroeconomic data, typically National Accounts. The main manual providing guidelines for this approach is the Balance of Payments and International Investment Position Manual (BPM6), which was drafted in parallel with the 2008 System of National Accounts of the United Nations (SNA 2008). The idea behind this approach is recording changes in the economic ownership of goods between residents and non-residents. For example, in the IMTS approach, goods sent for processing to a different country are recorded irrespectively of ownership change. However, in the second approach, goods sent abroad for processing without change of ownership and returned after processing are not recorded in the balance of payments.

Several global databases record bilateral trade flows as the United Nations Comtrade, the World Bank's World Integrated Trade Solution (WITS), and the IMF's Direction of Trade Statistics. Trade data in UN Comtrade, WITS, and IMF DOTS is provided directly as country-level statistical agencies report it. No adjustments or further refinements are made before publication. For example, the values of exports of Azerbaijan to Turkey and the imports of Azerbaijan from Turkey reported by the State Statistical Committee of the Republic of Azerbaijan from 2013 to 2019 are appearing the same in the databases mentioned above. For that reason, these databases are used widely in the following chapters to calculate intra-regional trade among the Turkic Council Member States.

International databases such as the UN Comtrade, WITS, and IMF DOTS are reliable in consolidating and standardizing trade statistics, making country comparisons possible. Still, asymmetries in trade statistics are hard to deal with because international organizations cannot know which of the two countries (if any) is reporting the correct value of the goods traded. Even when two reporting countries rely on the same broad accounting approach, discrepancies may arise due to, for example, the following reasons:

- Countries may fail to adhere perfectly to the guidelines used to record and report trade data.
- The guidelines on how to treat goods passing through intermediary countries for processing or merchanting may also be challenging to follow. Particularly as global production chains become complex, it becomes difficult to determine the origin and final merchandise destination unambiguously.
- Some countries use the special trade system (which excludes trade made in free zones), and others use the general trade system (which includes free zones).
- Some economies may report gross weights, and others may report net weights.
- Asymmetries may result if exports are registered in one year and the corresponding imports in the following year.
- Re-exports, re-import or transit may be taken into account by some countries.
- Differences in customs and tax regimes may also be a potential source of asymmetries.
- If a dataset reports cross-country trade data in foreign currencies, values will vary depending on the used exchange rates.

- Imports are generally reported based on Cost, Insurance, and Freight (CIF). In contrast, exports are reported on a Free on Board (FOB) basis. For this reason, import values tend to be higher than export values. Some countries may compile and publish the value of imported goods as a FOB-type value.
- Discrepancies in bilateral trade statistics may arise due to confidentiality policies, product classification, and deliberate misinvoicing for illicit purposes.

The asymmetries in bilateral trade data could lead to discrepancies in the valuation of goods traded between countries concerned. Moreover, countries that strictly follow national data may find some calculations disputable. It is recommended for Turkic Council to tackle bilateral trade asymmetries by identifying them on a case-by-case basis and reconcile the existing asymmetries in line with the international standards.

CHAPTER

II

Current Trends in Cross-Border Trade

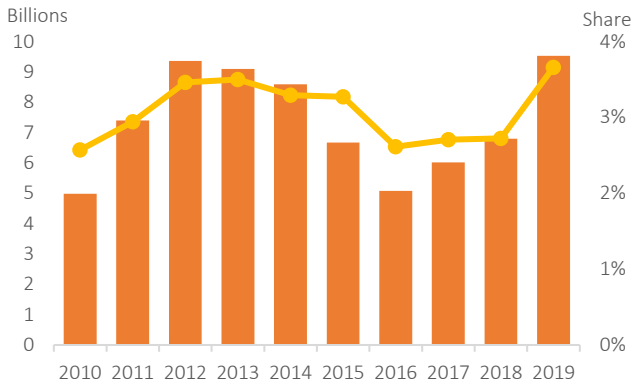
2 Current Trends in Cross-Border Trade

Turkic Council Member States place great importance on enhancing economic cooperation among them. They identified the "Economic Cooperation" as the central theme of the First Summit of the Cooperation Council of Turkic Speaking States, held in Almaty, Kazakhstan on 21 October 2011. In this context, economic cooperation remained at the heart of the actual cooperation mechanisms of the Turkic Council, which are managed by the regular meetings of Ministers in charge of Economy. The actions taken to facilitate cross-border trade have resulted in a growing trade relationship among the TC MCs. However, various obstacles hinder trade growth, such as lack of connectivity, burdensome customs procedures, lack of harmonized regulations and absence of proper business information centres, and competence and quality of logistics services. This chapter reviews the current trends in cross-border trade at national and sectoral levels among the Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey (TC-4) by utilizing international data sources. It provides essential insights into trade patterns and trade structure among the TC-4 economies and establishes the ground for in-depth analyses in the following chapters.

2.1 Intra-regional Trade

Total exports among the TC-4 economies reached near $9.4 billion in 2012. Over the following four years, it constantly fell to reach $5.1 billion in 2016. Since then, an upward trend has been observed in total intra-TC exports, which is recorded above $9.5 billion in 2019 (Figure 2.1). The share of intra-regional export in total exports of TC-4 economies declined from 3.5% in 2012 to 2.6% in 2016 and increased to 3.7% in 2019. A slightly different trend is observed in the share of total intra-regional trade volume (the share of intra-regional exports and imports in total exports and imports of the TC-4). After reaching 8.3% in 2012, the intra-regional trade share was steadily declining from 2013 to 2018 and recorded at 5.9% in 2019 (Figure 2.2). Considering the 2.35% share of TC-4

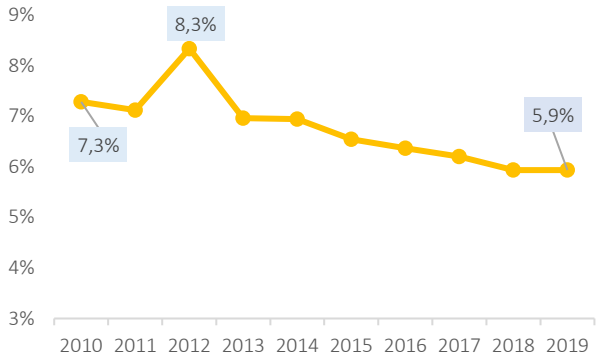
Figure 2.1: Intra-Regional Exports



Source: IMF DOT database.

economies in global GDP (see Chapter 1), their collective stake in international trade fairly represents their economic contribution to the world economy.

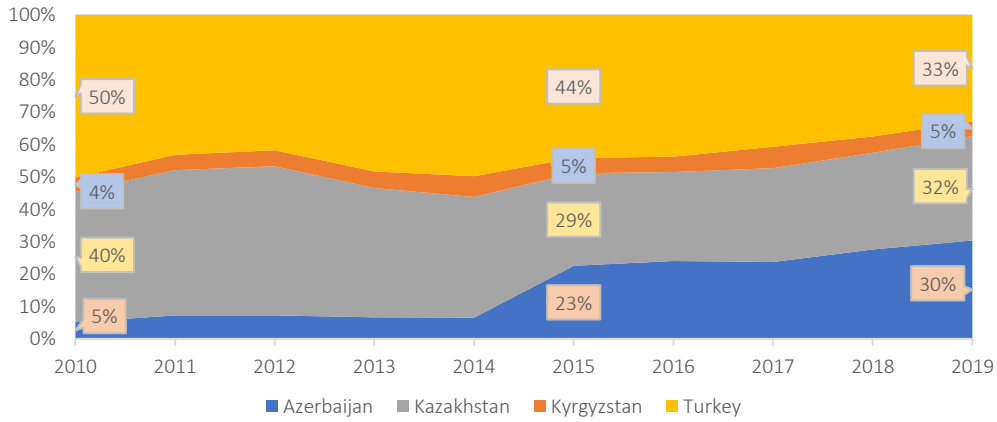
Figure 2.2: Share of Total Intra-Regional Trade



Source: IMF DOT database.

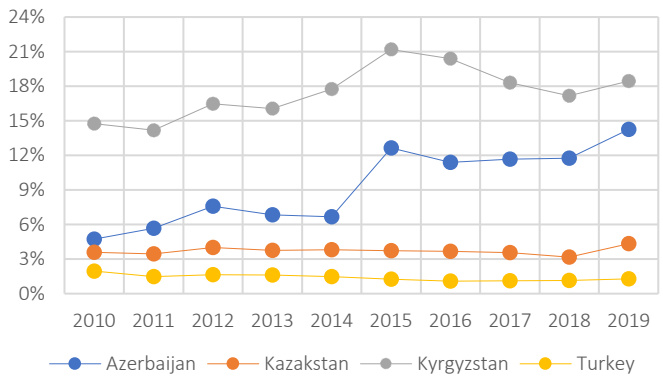
The size and development levels of TC-4 economies are not homogeneous. Turkey is the largest economy and accounts for more than three-quarters of the TC-4's total production. On the other hand, Kyrgyzstan has near 1% share in total output. Since there are only five Turkic Council Member States with different economic sizes, a single economy can affect the group totals and averages significantly. An economic boom or decline in a bigger Member State can result in a sharp rise or fall in aggregated TC-4 values. In this connection, Figure 2.3 shows the shares in intra-regional exports. Turkey, Kazakhstan, and Azerbaijan had the largest shares (above 30%) in intra-regional exports in 2019 (Figure 2.14). Share of Azerbaijan in intra TC-4 exports have significantly increased from 5% in 2010 to 30% in 2019. Turkey's share in intra-regional exports has diminished from 50% in 2010 to 33% in 2019. The similar negative trend is also observed with Kazakhstan, whose share in intra-regional exports slightly increased after 2017, reaching 32% in 2019. Kyrgyzstan's contribution in intra-regional exports has remained stable at around 5%.

Figure 2.3: Country Shares in Intra-Regional Exports



Source: IMF DOT database.

Figure 2.4: Share of TC-4 in Total Trade of Countries

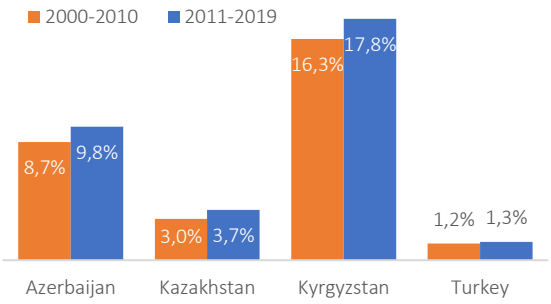


Source: IMF DOT database.

An important indicator in analyzing the bilateral integration within the TC-4 economies is trade with the other Member States. Despite the fall in the 2016-2018 period, Kyrgyzstan still has the highest share of trade with the rest of the TC-4, with a value of 18.4% in 2019. It is followed by Azerbaijan (14.2%) and Kazakhstan (4.3%). Although Turkey has the largest share in intra-TC-4 trade, its share in total trade of the country in 2019 was only 1.3%. On average, intra-TC-4 trade has more significant importance in Azerbaijan's and Kyrgyzstan's trade but lesser importance in Turkey's and Kazakhstan's trade (Figure 2.4).

Since the Turkic Council's establishment in 2011, Kyrgyzstan, with 17.8%, had an average share of trade with other TC-4 economies that is much higher than in the other Member States. For Azerbaijan, the rest of the TC-4 countries constitute essential trade partners. On average, they accounted for 9.8% of Azerbaijan's total trade volumes from 2011 to 2019. In the same period, the average share of trade with the TC-4 group was relatively lower in Kazakhstan (3.7%) and Turkey (1.3%). Still, it is promising to observe that from 2011 to 2019, the average shares of trade with the TC-4 group have increased in all countries compared to the 2000-2010 average values (Figure 2.5).

Figure 2.5: Average Share of TC-4 in Total Trade of Countries (2000-2010 and 2011-2019)



Source: IMF DOT database.

Bilateral trade relations of individual TC-4 economies show a high concentration of trade flows. Figure 2.6 shows the share of Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey trade partners for 2010 and 2019. Turkey has been the leading trade partner within the TC-4 group for Azerbaijan (Figure 2.6a). Kyrgyzstan became a more important partner for Kazakhstan, diminishing Azerbaijan's importance over the years (Figure 2.6b). For Kyrgyzstan, Turkey's significance in its trade relations substantially increased, resulting in a fall in Kazakhstan's share (Figure 2.6c). For Turkey, Kazakhstan remained its major trade partner. However, its share

Figure 2.6a: Azerbaijan's Trade Partners 2010 vs 2019

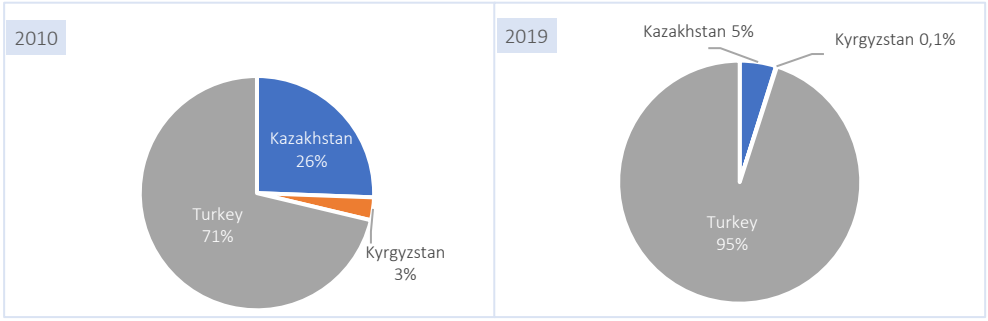


Figure 2.6b: Kazakhstan's Trade Partners 2010 vs 2019

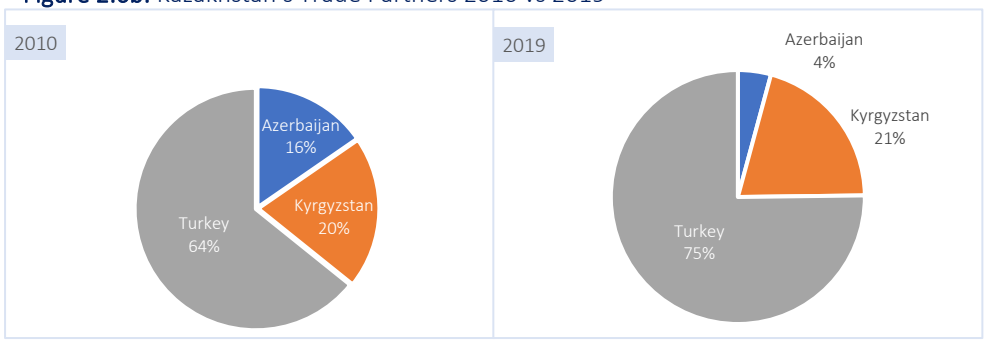


Figure 2.6c: Kyrgyzstan's Trade Partners 2010 vs 2019

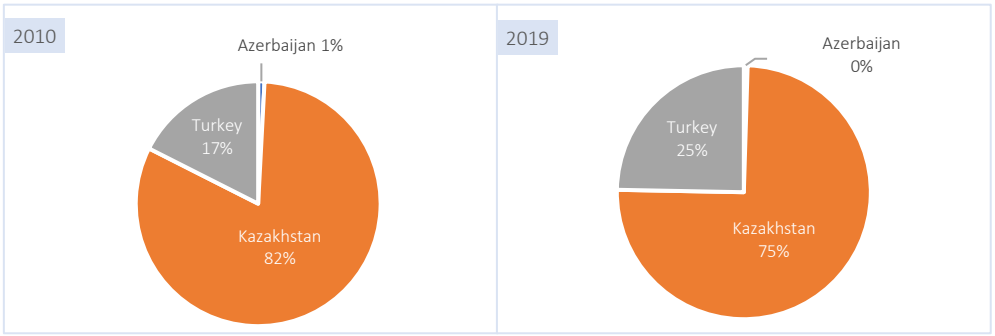
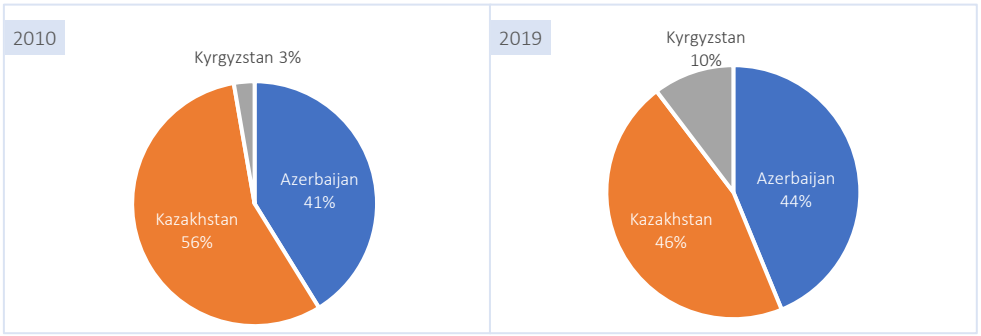


Figure 2.6d: Turkey's Trade Partners 2010 vs 2019

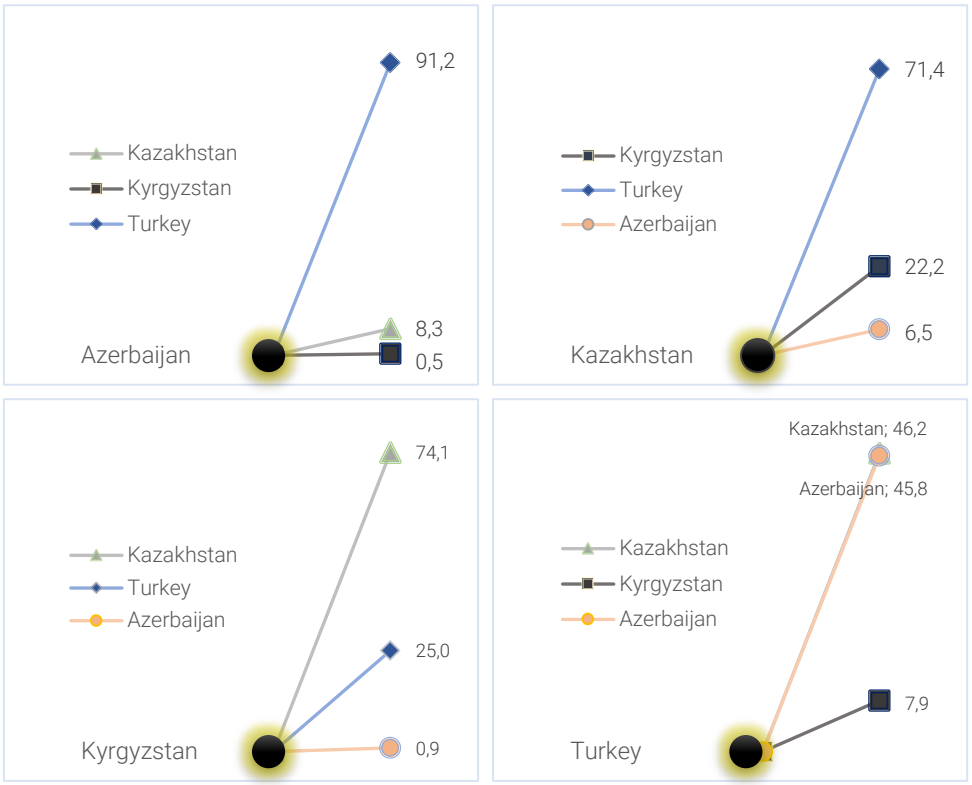


Source: IMF DOT database.

declined ten percentage points, while Kyrgyzstan's share increased seven percentage points (Figure 2.6d).

To avoid year-specific effects on the distribution of trade flows, the sum of trade volume between 2011 and 2019 is calculated and depicted in Figure 2.7. During this period, Turkey remained Azerbaijan's most important trade partner with near 91% share. Turkey is also the most important trade partner of Kazakhstan with over 71% share, followed by Kyrgyzstan (22.2%) and Azerbaijan (6.5%). On the other hand, Kazakhstan is the primary trade partner of Kyrgyzstan with 74.1%. Azerbaijan has a negligible share (0.9%) in Kyrgyzstan's trade with TC-4. Finally, for Turkey, Kazakhstan and Azerbaijan stand out as equally essential trade partners with around 46% trade share with each of them. Kyrgyzstan accounts for 6.5% of Turkey's trade with the TC-4 group (Figure 2.7).

Figure 2.7: Distribution of Trade with Other TC-4 (2011-2019, percent)

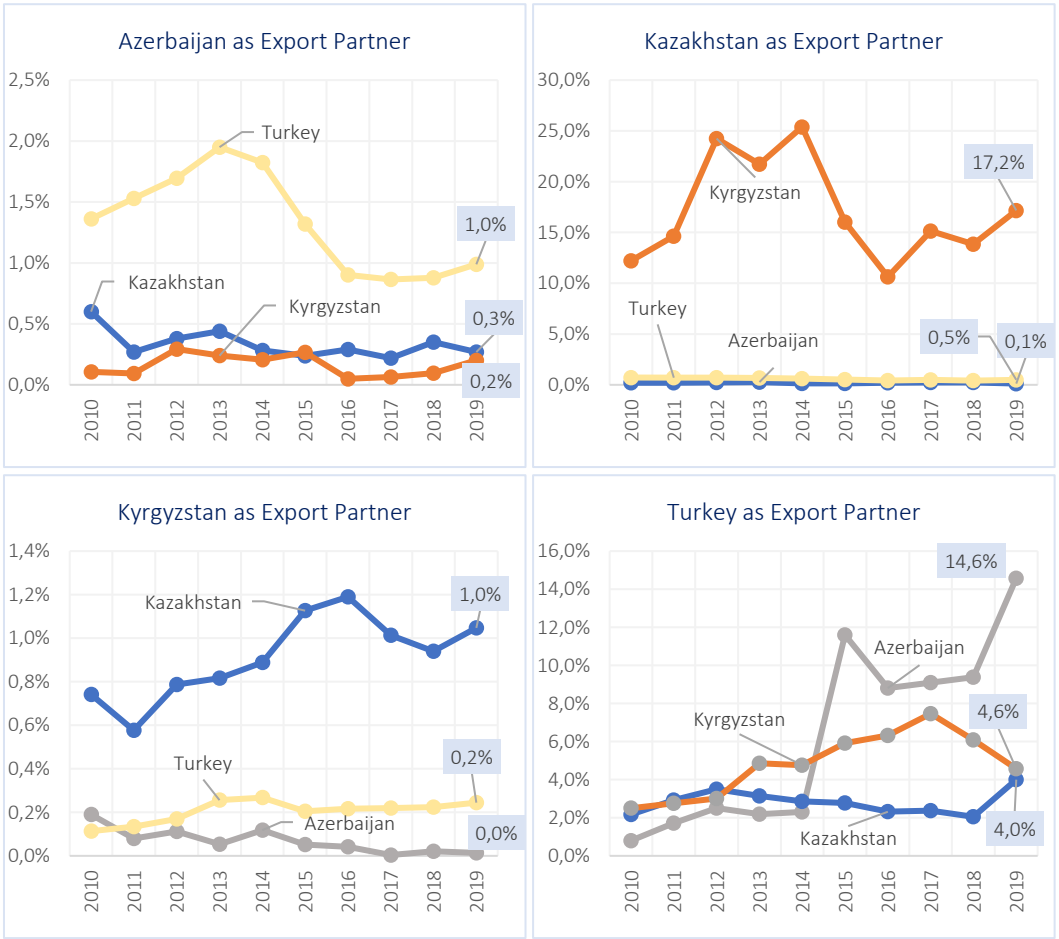


Source: IMF DOT database.

It can be argued that trade relations between Turkey and the rest of the TC-4 group are strong, but further improvements would be needed to improve the trade relations between Azerbaijan and Kyrgyzstan as well as Azerbaijan and Kazakhstan. More discussion on how to facilitate trade among the Member States will be provided in the next chapters.

Before proceeding to sectoral and product-level analyses, it is also illuminating to evaluate individual countries' relative importance as an export partner of remaining TC-4 economies in their exports to the world. Figure 2.8 reveals that Azerbaijan does not appear to be a significant export partner for Kazakhstan and Kyrgyzstan. However, it is a relatively more important market for Turkey's export products, albeit visible fluctuations. Kazakhstan is a major destination for Kyrgyzstan's exporters with a share of around 17%. However, it does not constitute a significant destination for other TC-4 countries. The case of Kyrgyzstan resembles the case of Azerbaijan, where only one country (Kazakhstan) exports as much as 1% of its export products to Kyrgyzstan, while this number is much lower for Turkey and Azerbaijan. On the other hand, Turkey is an essential market for Azerbaijan, and 14.6% of Azerbaijan's exports reached Turkey in 2019.

Figure 2.8: TC-4 Countries as Export Partners (Percent)



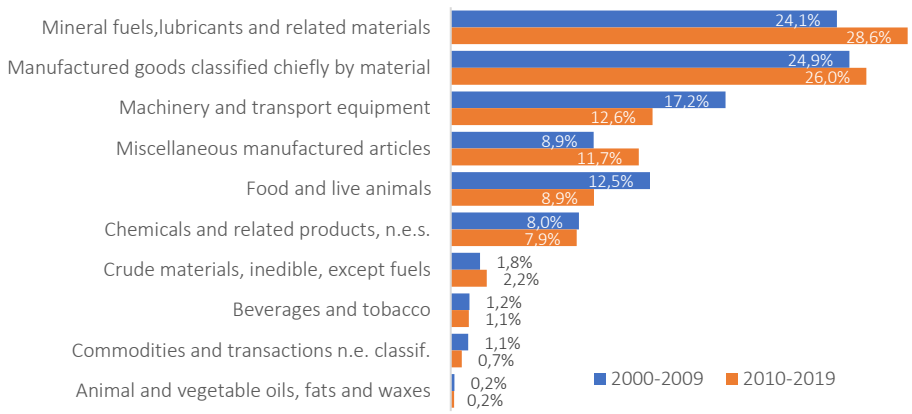
Source: IMF DOT database.

2.2 Trade Patterns at Sectoral and Commodity Level

Trade figures at aggregate levels show the diverse relationship among the TC-4 economies. While there are continually improving trade relations among some countries, the opposite trend is observed in some other trade relations. Different factors can explain the divergent patterns of relationships such as complementarities in export products, bilateral trade agreements and relative trade costs. Before proceeding to an in-depth analysis of such factors, this subsection investigates the leading sectors and products currently constituting the main trade items between the TC-4 economies.

To avoid annual fluctuations and to give a broader picture of the distribution of trade at sectoral level (classified according to SITC at two-digit level), the averages are calculated for the period between 2000-2009 and 2010-2019 to compare the changes over the last decade (Figure 2.9). Manufactured goods had the highest share during the 2000s, and with a share of 26%, it became an even more important sector in trade relations among the TC-4 countries. The second most important sector is mineral fuels, lubricants and related materials. Particularly Azerbaijan and Kazakhstan are rich in natural resources, and these resources constitute a significant share of their exports. During the 2010s, mineral fuels accounted for 28.6 % of total intra-TC-4 trade. The third important sector is the machinery and transport equipment, whose share has declined from 17.2% in the 2000s to 12.6% in 2010s. Similarly, the percentage of food and animals declined from 12.5% to 8.9% and became the fifth-largest intra-TC trade sector. On the other hand, the share of miscellaneous manufactured articles increased from 8.9% to 11.7% and became the fourth largest sector.

Figure 2.9: Sectoral Trade among TC-4 Countries (Percent)

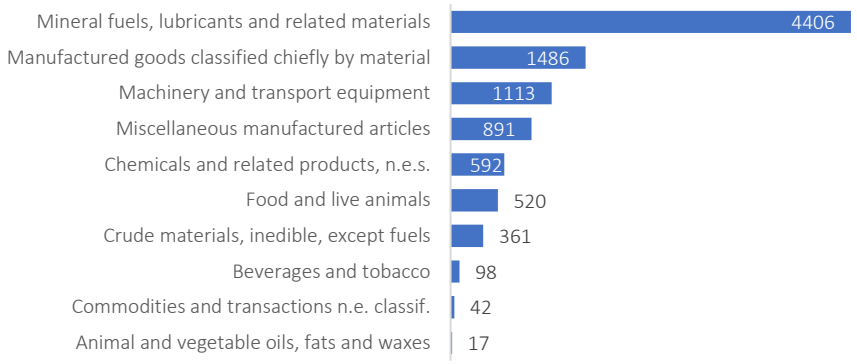


Source: UN Comtrade database SITC2 classification.

While Figure 2.9 shows average shares of sectors over almost two decades, Figure 2.10 shows the latest trade distribution among the TC-4 economies. Although around a quarter of trade data is not classified yet, Figure 2.10 still provides important insights. In 2019, mineral fuels, lubricants and related materials constituted the bulk of trade ($4.4 billion) among TC-4

countries. This sector was followed by manufactured goods classified chiefly by material (near $1.5 billion) and machinery and transport equipment ($1.1 billion). Values of other can be followed from the related figure.

Figure 2.10: Sectoral Trade among TC-4 Economies (Exports, 2019, million $US)



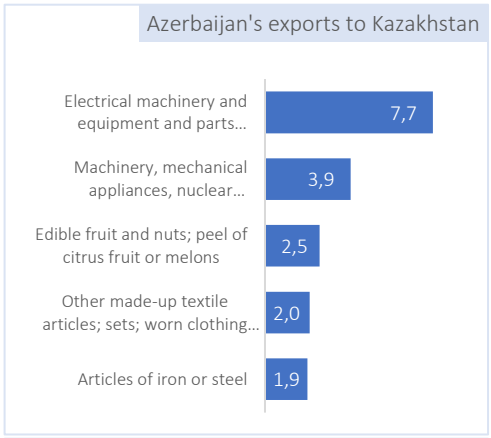
Source: UN Comtrade database SITC2 classification.

TC-4 countries have a different mix of resources and level of development that shape their trade patterns. To provide more details on the bilateral trade structure, the top 5 products in bilateral exports are calculated using International Trade Centre Trade Map Database. In 2019, Azerbaijan's export to Turkey was heavily concentrated on mineral fuels, oils, and derivatives (Figure 2.11a). Since Turkey is the leading export partner of Azerbaijan within the TC-4, it is fair to say that Azerbaijan's regional exports in 2019 were based mostly on natural resources. Azerbaijan's exports to Kazakhstan and Kyrgyzstan are relatively more diversified compared to exports to Turkey.

Regional exports of Kazakhstan reveal less product concentration compared to Azerbaijan. Kazakhstan's exports to Azerbaijan in 2019 were mainly cereals ($46.9 million) and mineral fuels ($36.2 million). Exports to Kyrgyzstan were relatively more concentrated where mineral fuels accounted for the bulk of Kazakhstan exports at $129,7 million. Again, Turkey was an important market for mineral fuels from Kazakhstan with near $1.7 billion worth of exports in 2019. Other major export items were mainly resource-based products, such as copper and aluminum (Figure 2.11b).

Product complementarities shape trade relations of Kyrgyzstan with rest of the TC-4 countries. As a resource-scarce country, export products are concentrated in several main items. In 2019 Kyrgyzstan's exports to Azerbaijan mainly constituted aircraft and parts ($1.4 million) and edible vegetables ($1.2 million). In the same year, Turkey imports from Kyrgyzstan were mostly concentrated on edible vegetables ($27.6 million), mineral fuels ($22.6 million) and cotton ($21.9 million) (Figure 2.11c).

Figure 2.11a: Azerbaijan's Regional Exports (Top 5 products, million $US, 2019)



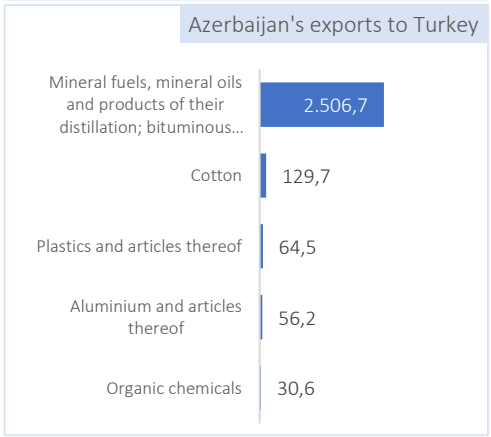
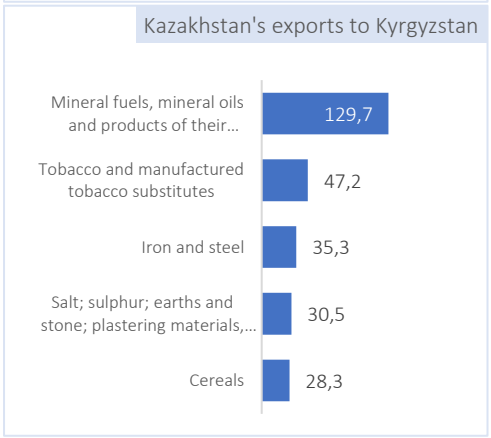
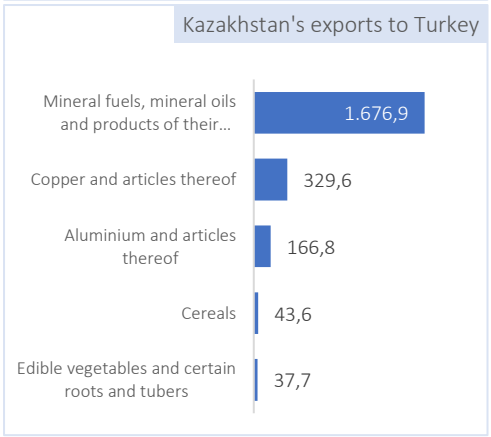


Figure 2.11b: Kazakhstan's Regional Export (Top 5 products, million $US, 2019)

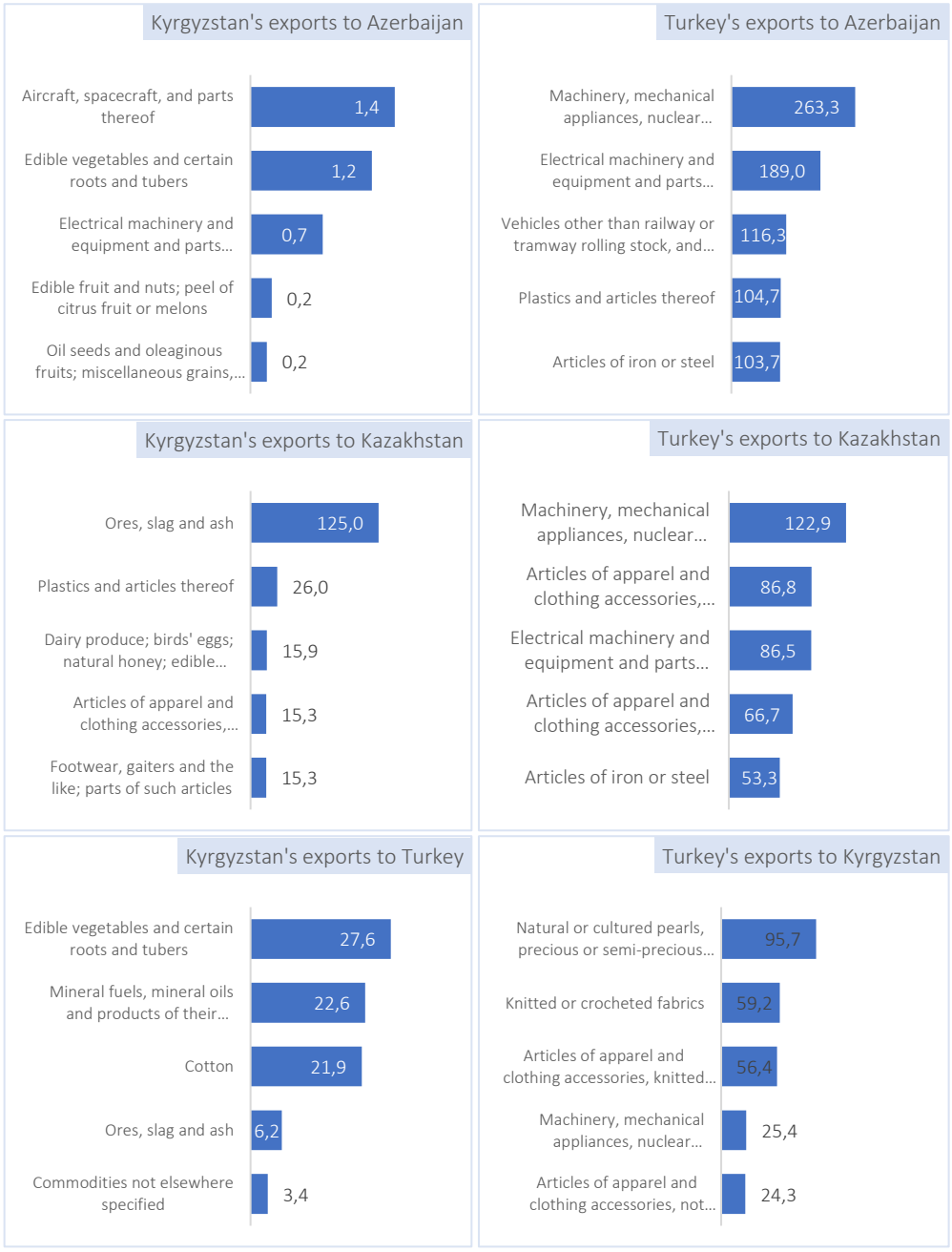




Source: TradeMap, International Trade Centre.

Figure 2.11c: Kyrgyzstan's Regional Exports (Top 5 products, million $US, 2019)

Figure 2.11d: Turkey's Regional Exports (Top 5 products, million $US, 2019)



Source: TradeMap, International Trade Centre.

Turkey's regional exports are predominantly manufacturing products. In 2019, it exported to Azerbaijan mostly machinery ($263.3 million), and electrical machinery and equipment ($189

million), followed by vehicles, plastics, and articles of iron or steel. Machinery dominated Turkey's exports to Kazakhstan with $122,9 million in 2019. Articles of apparel and clothing accessories were also significant components in Turkey's exports to Kazakhstan (Figure 2.11d).

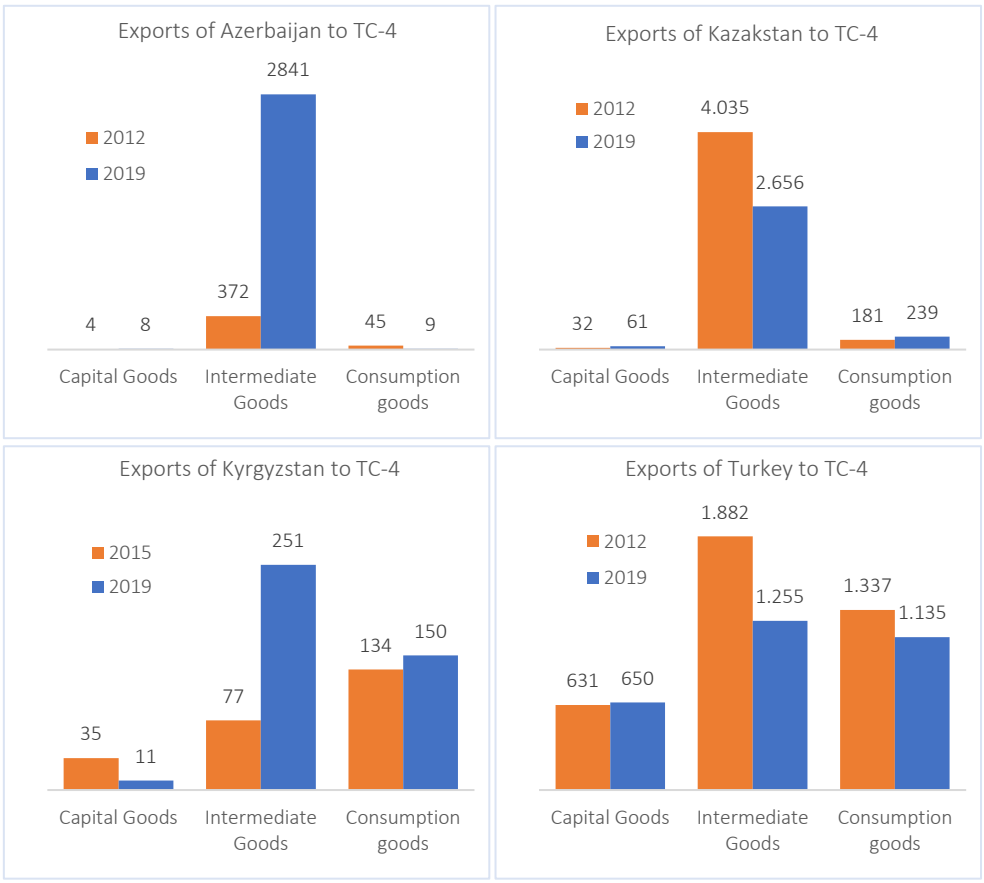
Globalization, falling trade costs, and technological progress have led to the fragmentation of production processes and global value chain growth. Firms started to obtain intermediate inputs from the most cost and time-effective producers regardless of their geographical location. This interconnectedness was also among the main drivers of rapid growth in global trade. An analysis in this connection is possible thanks to international trade statistics classification by broad economic category (BEC), managed by the United Nations and reported under the COMTRADE database. These statistics allow international trade data conversion based on the standard international trade classification (SITC) into the three basic goods: capital, intermediate, and consumption goods.

Capital goods are those goods that help in the manufacturing of consumption goods or intermediate goods. The capital goods are in themselves final but are not used by people but by the industry to manufacture other goods. They generally include the machines, tools, and equipment. Intermediate goods are those goods that are necessary for the manufacturing of final goods. These may consist of semi-finished parts/equipment or output of an industry used as another sector input. Finally, consumption goods are meant for consumers, which can be durable or non-durable.

Figure 2.12 shows the distribution of trade according to three broad types of goods explained above. The structure of products exported by Azerbaijan has sightly changed over time. While 11% of its exports were consumption goods in 2012, almost 99% of its exports were intermediate goods in 2019. Kazakhstan was also exporting mainly intermediate goods, but its share had decreased from 95% in 2012 to 90% in 2019. In the same period, Kazakhstan's export of consumption and capital goods has been doubled. Intermediate goods also represent the largest share in Kyrgyzstan exports. However, capital goods also have a significant stake in the total exports of the country. Turkey remained an exporter of all types of goods, but the export of intermediate goods' share in trade with TC-4 has significantly declined in 2019 compared to 2012.

A high share of intermediate goods in total exports of TC-4 economies implies the existence of considerable interconnectedness in the supply chain across the countries. It could indicate the more significant economic integration potential among the Turkic Council Member States if existing barriers to further development of trade and investment are well identified and removed.

Figure 2.12: Structure of Trade among TC-4 Countries (Million $US)



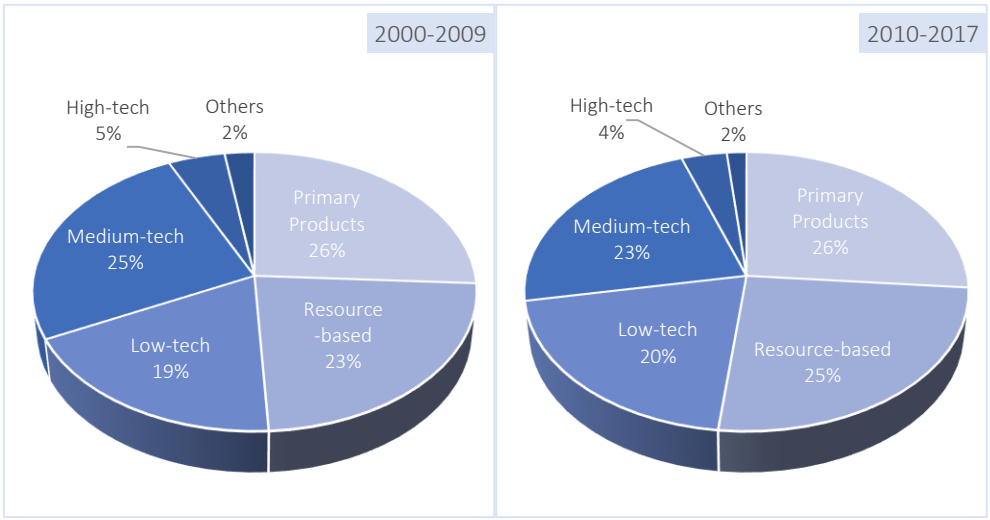
Source: UN Comtrade database.

In addition to the classification of goods by their type, their technological intensity can be classified. It is argued in the literature that export structures have implications for growth and development. In categorizing the goods according to technological intensity, products can be grouped under primary, resource-based manufacturing, low-technology manufacturing, medium-technology manufacturing, and high-technology manufacturing (see S. Lall, "The Technological Structure and Performance of Developing Country Manufactured Exports, 1985-1998," QEH Working Paper Series, 2000). Primary products such as fresh fruit, meat, rice, cocoa, tea, coffee, wood, coal, crude petroleum, and gas do not represent any technological content. When the TC-4 countries' average performances during 2000-2009 vs. 2010-2017 are compared, a fixed share of exports (26%) among TC-4 constituted primary products (Figure 2.13). However, in 2019 share of primary products accounted for 52% of all intra-regional exports.

Resource based products tend to be labor-intensive and straightforward (e.g., simple food or leather processing), but there are sectors using capital, scale, and skill-intensive technologies

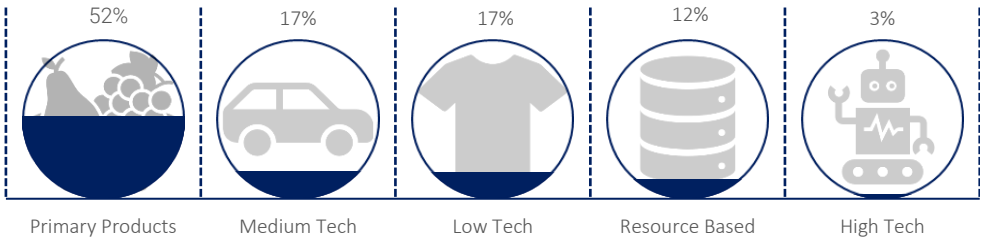
(e.g., petroleum refining or modern processed foods). The share of these products in intra-TC trade increased from 23% to 25% during the period under consideration. Long-term analysis of the technological intensity of intra-TC-4 exports shows that more than half of the regional trade represents zero or close-to-zero technological intensive products. However, according to 2019 data, primary and resource-based products accounted for 64% of total TC-4 regional exports (Figure 2.14).

Figure 2.13: Structure of Exports among TC-4 by Technological Intensity



Source: UN Comtrade database.

Figure 2.14: Technological Classification of Intra-TC-4 Exports (regional level, 2019)



Source: Un Comtrade database, Lall (2000).
Note: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey are included.

Low technology products tend to have stable, well-diffused technologies. They are undifferentiated products where the technologies are mainly embodied in the capital equipment. These include textile fabrics, leather products, footwear, furniture, toys, and plastic products. From 2000 to 2017, around 20% of all intra-TC exports represent low technological intensity. In 2019 these products accounted for 17% of regional exports.

Medium technology-intensive products tend to have complex technologies, with moderately high levels of R&D, advanced skill needs, and lengthy learning periods. Automotive products, processing industries (such as synthetic fibres, chemicals and paints, and fertilizers), and engineering industries (such as engines, motors, industrial machinery, and watches) are the common examples of medium-technology products. Their share in total intra-TC exports declined from 25% during 2000-2009 to 23% from 2010-2017. Data for 2019 indicates that the percentage of medium-technology products was 17%.

High-technology products, including electronics and electrical products, pharmaceuticals, aerospace, and optical instruments, declined from 5% to 4% in the long period from 2000 to 2017, and to 3% in 2019. Turkey and Kazakhstan mostly export technology containing products.

It could be concluded that the technological intensity of the products exported among TC-4 economies has declined over a long period. High-tech products are generally delivered from distant advanced economies, explaining the limited intra-regional trade among the TC-4 countries. Still, it could be argued that Turkic Council Member States are not aware of possible complementarities in medium and high technology products to trade with each other. There is a need to increase cooperation and partnership among the Member States to increase medium and high technology products and facilitate these goods' regional trade.

Similar to the analysis of products' technological intensity, exported goods can also be classified according to their price levels. CEPII provides a systematic decomposition of world trade using a new database built on a harmonized version of trade unit values, which classify the goods as low, medium, and high price products. Such commodities classification allows evaluation of the quality of products exported among the TC-4, assuming that prices are an indicator of products' quality and sophistication.

Figure 2.15a shows the trade patterns of TC-4 with the rest of the world. Azerbaijan and Kazakhstan appear to export a fair share of products at the medium price range. However, the percentage of products at high price range is around 11-12%. In Kyrgyzstan, the share of products at a low price range is as much as 33%, while medium price range products account for 48% of its total exports. Turkey exports the largest amount of low price range products with almost 44% share, but more than 21% of its exports represent high price products.

Trade structure among the TC-4 economies, as depicted in Figure 2.15b, reveals significant divergence compared to their trade with the rest of the world. Azerbaijan exports comparably a larger share of high price products and low price products compared to its world exports, but the much lower percentage of medium price products. In Kazakhstan, low price products account for a larger share of exports to TC-4 than its exports to the world. A similar observation is more pronounced in Kyrgyzstan, whose exports to TC-4 constitute mainly low price products. The same remark is also true in Turkey, where low price products account for a larger

share of exports to TC-4 than exports to the world. As a result, it can be argued that intra-TC-4 trade constitutes relatively lower quality products than their exports to the world.

Figure 2.15a: Trade with World by Price Range (2010-2018)

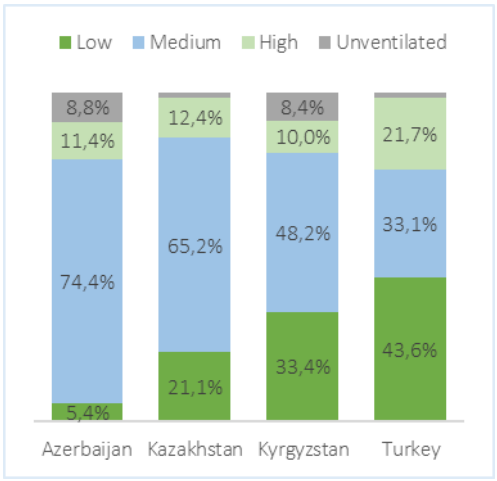
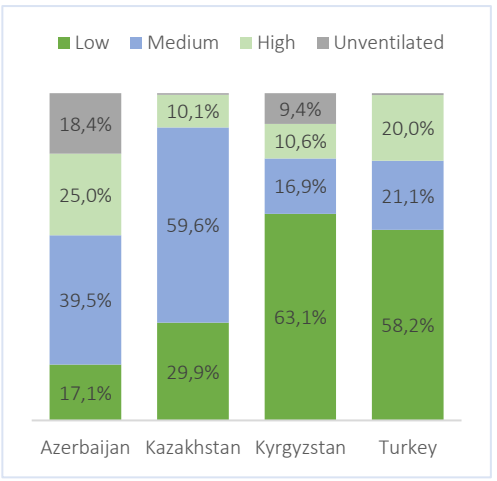


Figure 2.15b: Trade with TC-4 by Price Range (2010-2018)



Source: CEPII WTFC database.

A final disaggregation of trade data is by their types. Trade products can be inter-industry or intra-industry. Inter-industry trade refers to the exchange of products belonging to different industries. More specifically, exports and imports between countries consist of different types of goods. Such trade is based on differences in factor endowments. On the other hand, intra-industry trade refers to exchanging similar products belonging to the same industry. A higher share of intra-industry trade implies a greater variety of products being traded in the same industry, reflecting higher specialization in products with greater interconnectedness in production processes and supply chain. While price ladders inform on countries' specialization along the price ranges, trade types can serve as indicators of economic similarity by quantifying the extent to which bilateral imports and exports are matched within sectors.

Figure 2.16 shows the disaggregated data for inter-industry trade (or one-way trade – OWT), horizontal intra-industry trade, i.e., intra-industry trade in similar products (TWH), and vertical intra-industry trade, i.e., intra-industry trade in differentiated products. Two-way trade (TWT) represents the share of intra-industry trade where a distinction cannot be made whether it is in similar products or differentiated products due to missing unit values.

Trade patterns of Azerbaijan, Kazakhstan, and Kyrgyzstan with the world demonstrate a heavy concentration of inter-industry trade with a share of between 94%-98% (Figure 2.16a). This share is also significantly high in Turkey (77%), but intra-industry trade in similar products (7.5%) and intra-industry trade in differentiated products (14.9%) account for almost one-quarter of its trade with the world.

Figure 2.16a: Types of Trade with World (2010-2018 average)

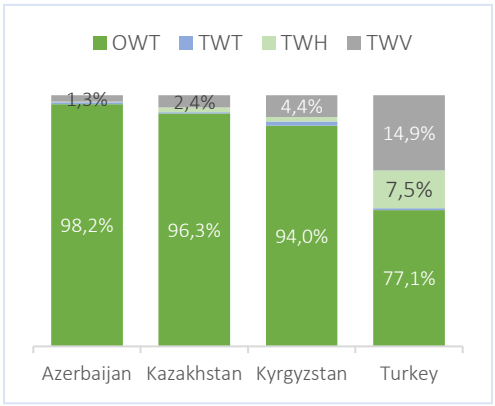
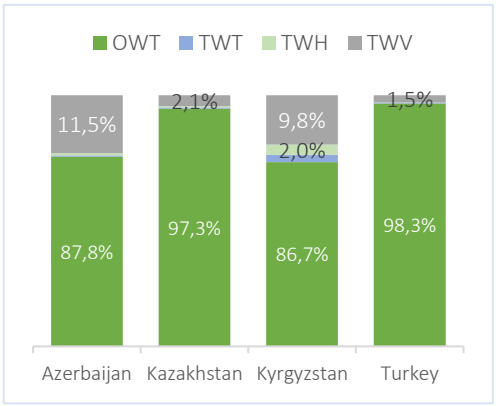


Figure 2.16b: Types of Trade with TC-4 (2010-2018 average)



Source: CEPII WTFC database.

Intra-TC-4 trade patterns show some divergence from the Member States' trade patterns with the world (Figure 2.16b). While Azerbaijan and Kyrgyzstan have a larger share of vertical intra-industry trade with the TC-4 group, Turkey trade mostly in inter-industry products. This result implies that the bulk of the trade among TC-4 takes place inter-industry, indicating significant complementarities in the trade of goods across industries. However, there is less integration in terms of production processes.

CHAPTER

III

Trade Policies and Barriers to Trade

3 Trade Policies and Barriers to Trade

Trade policies refer to the policy framework, laws, regulations, and international agreements used to affect international trade flows mainly through tariffs and non-tariff measures. The main objective of trade policy is to maximize the nation's welfare through increased economic efficiency (Bartók and Miroudot, 2008). It also aims to improve domestic firms' market access, promote productivity growth, and facilitate the economy's integration into global markets.

A barrier to trade is a government-imposed restriction on the flow of foreign goods or services. Governments usually have different motivations for restricting trade flows across borders. The most common justifications for trade barriers are to protect infant industries for them to become more competitive in global markets, to protect jobs, and to increase government revenues. However, it is also quite often claimed that protectionism harms economies by raising prices, reducing competitiveness, and diminishing technological development and innovation prospects.

This chapter reviews the trade policies adopted by Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey (TC-4), particularly concerning the flow of goods among themselves. It analyses the tariff and non-tariff barriers to trade, evaluates the bilateral trade costs and custom procedures, and discusses some aspects of trade facilitation among the TC-4 economies.

3.1 Review of Trade Policies

Azerbaijan has had observer status at the World Trade Organization (WTO) since 1997 and began negotiations with WTO members on accession in 2004. Since then, Azerbaijan has introduced significant legislative, regulatory, and institutional reforms to meet the WTO requirements. Progress on goods and services negotiations has also been achieved. The WTO membership policy and legal reforms process in Azerbaijan is ongoing with different government bodies' involvement, including efforts for building political and private sector support for WTO accession. However, progress on accession is partly affected by the government's decision to support the domestic agriculture sector (ITA, 2019). Azerbaijan has free trade agreements (FTAs) with Russia, Moldova, Georgia, Uzbekistan, Turkmenistan, Kazakhstan, Kyrgyzstan, Belarus, Ukraine, and Tajikistan, which allow imports of goods from those countries free of customs duties. With the Cabinet of Minister's decision No. 500 dated 17 November 2017, Azerbaijan's highest ad valorem import duty is restricted to 15 percent. According to the State Statistical Committee of Azerbaijan, the average weighted tariff rate in Azerbaijan was 4.73% in 2019. It should be noted that the Preferential Trade Agreement between Azerbaijan and Turkey was signed on 25 February 2020 and entered into force on 1 March 2021 (Table 3.2).

Kazakhstan joined the WTO in 2015. Under its WTO commitments, Kazakhstan agreed to gradually lower 3,512 tariff rates to an average of 6.1% by 2020. Kazakhstan introduced administrative measures to prevent the re-export of goods released at these lower tariff rates to Armenia, Belarus, Kyrgyzstan, or Russia. Kazakhstan is part of the Commonwealth of Independent States Free Trade Area. It is also a founding member of the Eurasian Economic Union (EEU) and the EEU Customs Union. EEU regulations have heavily influenced Kazakhstan's trade policy. The EEC implements an external trade policy for its member states and coordinates economic integration policies among them. The EEU Customs Code governs customs rules for all members. Most of Kazakhstan's import tariff levels, trade-in-transit practices, non-tariff import measures, and customs policies are based on EEU legal instruments.

Kyrgyzstan has been a member of WTO since 1998. Like Kazakhstan, Kyrgyzstan is part of the EEU Customs Union and the Commonwealth of Independent States Free Trade Area. With its entry into the EEU Customs Union, the average import tariff rate increased from 5% to 9.4% (ITA, 2019). Kyrgyzstan has bilateral investment treaties with 26 countries, including Azerbaijan, Kazakhstan, and Turkey. It has also signed double-taxation treaties with 27 countries, including Kazakhstan and Turkey.

Turkey has been a member of WTO since March 1995 and a member of GATT since October 1951. Turkey has bound over half of its tariff lines under the WTO (USTR, 2019). Turkey has also been a Customs Union partner with the European Union (EU) since 1996, as the Parties agreed on1/95 no Association Council Decision (ACD) that establishes the EU-Turkey Customs Union. Following that Decision, the Parties, in bilateral trade, eliminated the customs duties and quantitative restrictions for industrial goods and industrial components of agricultural products. Moreover, preferential trade in agricultural products is governed by the Additional Protocol and ACDs No 1/98, 2/2006, and 1/2007.

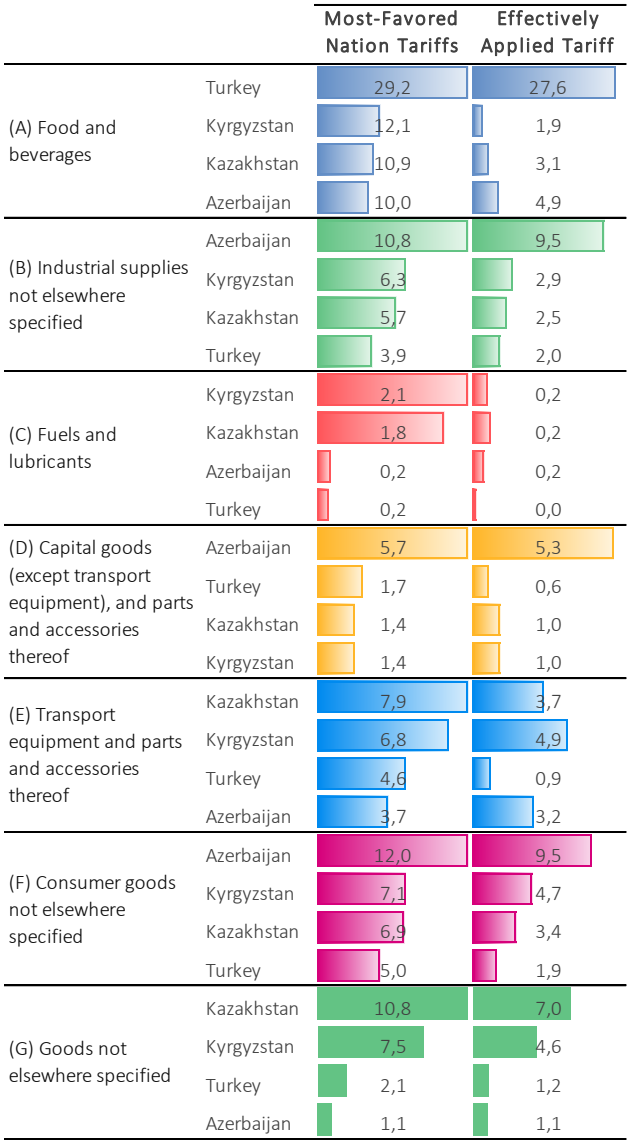
In line with the Customs Union Decision, Turkey negotiates and concludes free trade agreements with the third countries, parallel with the EU. Currently, Turkey has 21 FTAs in force (with EFTA (1992), Israel (1997), North Macedonia (2000), Bosnia and Herzegovina (2003), Tunisia (2005), Palestine (2005), Morocco (2006), Egypt (2007), Albania (2008), Georgia (2008), Montenegro (2010), Serbia (2010), Chile (2011), South Korea (2013), Mauritius (2013), Malaysia (2015), Moldova (2016), Faroe Islands (2017), Singapore (2017), Kosovo (2019) and Venezuela (2020). By and of 2020, FTAs signed by Lebanon, Sudan, Qatar, and United Kingdom were under ratification process (Table 3.2).

3.2 Barriers to Trade

Countries commonly use trade policy measures, including tariffs and non-tariff barriers, to discourage foreign products' imports and spur industrial growth and economic diversification aligned with national development and industrialization policies. Support measures introduced for particular industrial sectors, combined with tariff and other trade measures,

aim to protect these sectors from the foreign competition on the domestic market and boost their export performance at the same time. Such trade policies affect economic activity and well-being not only in the country enacting these policies but also in their trade partner countries.

Figure 3.1: Average Tariff Rates Applied (2019)



Source: WITS - World Bank based on TRAINS.
Note: Average tariffs weighted by their corresponding trade value are used. Effectively applied tariff is defined as the lowest available tariff. If a preferential tariff exists, it will be used as the effectively applied tariff. Otherwise, the MFN applied tariff is used.

The most common barrier to trade has been a tariff or a tax on imported goods. Tariffs raise the price of foreign goods relative to domestic goods. Global efforts towards facilitating trade flows across borders over the last several decades reduced the average tariff rates to historically their lowest levels. Nonetheless, it remains a usual practice by governments to apply certain level of tariffs to protect particular sectors or industries.

Figure 3.1 shows the average tariff rates applied by TC-4 in 2019, weighted by their corresponding trade value. Azerbaijan applied the highest Most Favoured Nation (MFN) tariff rates in three commodity groups (B, D, and F) and lowest MFN in the other three groups (A, E, and G).

In the same year, Kazakhstan has practiced the highest MFN in transport equipment (E) and G commodity groups. Kazakhstan applies a zero percent rate on approximately 1,900 tariff lines, including livestock, fish products, chemical and pharmaceutical products, cotton, machinery and equipment, medical vehicles, and some types of airplanes (USTR, 2019).

MFN applied by Kyrgyzstan was highest in fuels and lubricants (C) and the lowest in capital goods (D). In Turkey's case, the highest MFN was introduced in food and beverages (A), while in B, C, and F commodity groups, average tariffs were lowest.

At the TC-4 level, the highest liberalization was achieved in fuels and lubricants (C) and capital goods (D), whereas commodities falling into the food and beverages group (A) were subject to the greatest average tariff rates. In 2019, on average, Turkey applied 29.2% MFN tariff rates and 27.6% preferential tariff rates for the product falling under this category.

As shown in Figure 3.1, the average effectively applied tariffs in preferential trade agreements were significantly lower than MFN rates. A simple average of tariffs listed in Figure 3.1 shows that in 2019 the average weighted MFN tariff for all goods was 6.2% in Azerbaijan and Kyrgyzstan, 6.5% in Kazakhstan, and 7.7% in Turkey. In preferential trade agreements, the grand average of the effectively applied tariffs was 2.9% in Kyrgyzstan, 3% in Kazakhstan, 4.8% in Azerbaijan, and 5.7% in Turkey.

Tables 3.1 show the top 10 product groups with the highest average weighted MFN rates applied by TC-4 countries in 2019 to foreign producers. The highest MFN rate applied by Azerbaijan is approximately 15%, including tobacco, travel goods, articles of apparel, gold, dairy products, animal oils, essential oils, meat, and leather.

The highest average tariffs applied by Kazakhstan ranged between 9.86% and 29.08% in the same year. Meat and meat preparations were subject to a 29.8% tariff rate. Dairy products, travel goods, tobacco, and articles of apparel were among product groups, with the highest average tariff rates between 12%-14%. Meat and meat preparations were also subject to the highest tariff rates in Kyrgyzstan (48.36%), whereas products such as tobacco, dairy products, travel goods, vegetable fats, sugar, and articles of apparel were subject to a tariff rate between 11%-18.5%. Most of the tariff affected products in Azerbaijan, Kazakhstan, and Kyrgyzstan have no or low technological intensity. This indicates that these countries primarily aim to protect low-skill intensive jobs against the foreign competition to protect their livelihoods and earnings.

In 2019, Turkey introduced 138.19% average MFN tariffs on meat and meat preparations, 118.25% on dairy products, and 81.89% on sugars. The rest of the top 10 product groups with the highest average applied tariffs were subject to tariff rates between 15% and 41% (Table 3.1). While Turkey puts above-the-average tariff rates for certain agricultural commodities, it follows relatively free trade for other product items.

Table 3.1: Top 10 Products with Highest Average Applied Tariffs (2019)

Azerbaijan

	Product Name	Weighted Average
12	Tobacco and tobacco manufactures	15
83	Travel goods, handbags and similar containers	15
84	Articles of apparel and clothing accessories	15
96	Coin (other than gold coin), not being legal tender	15
97	Gold, non-monetary (excluding gold ores and concentrates)	15
02	Dairy products and birds & eggs	14.99
41	Animal oils and fats	14.98
55	Essential oils and resinoids and perfume materials	14.97
01	Meat and meat preparations	14.95
61	Leather, leather manufactures, n.e.s., and dressed furskins	14.95

Kazakhstan

	Product Name	Weighted Average
01	Meat and meat preparations	29.08
02	Dairy products and birds & eggs	13.58
83	Travel goods, handbags and similar containers	12.79
12	Tobacco and tobacco manufactures	12.34
84	Articles of apparel and clothing accessories	12.18
42	Fixed vegetable fats and oils, crude, refined or fractionated	10.46
11	Beverages	10.3
04	Cereals and cereal preparations	9.95
78	Road vehicles (including air-cushion vehicles)	9.95
06	Sugars, sugar preparations and honey	9.86

Kyrgyzstan

	Product Name	Weighted Average
01	Meat and meat preparations	48.36
12	Tobacco and tobacco manufactures	18.37
02	Dairy products and birds & eggs	13.77
83	Travel goods, handbags and similar containers	13.29
42	Fixed vegetable fats and oils, crude, refined or fractionated	12.92
06	Sugars, sugar preparations and honey	12.52
84	Articles of apparel and clothing accessories	11.04
41	Animal oils and fats	10.26
66	Non-metallic mineral manufactures, n.e.s.	9.78
09	Miscellaneous edible products and preparations	9.71

Turkey

	Product Name	Weighted Average
01	Meat and meat preparations	138.19
02	Dairy products and birds & eggs	118.25
06	Sugars, sugar preparations and honey	81.89
05	Vegetables and fruit	40.81
04	Cereals and cereal preparations	38.8
12	Tobacco and tobacco manufactures	29.39
42	Fixed vegetable fats and oils, crude, refined or fractionated	28.89
09	Miscellaneous edible products and preparations	28.88
03	Fish (not marine mammals), crustaceans, molluscs and aquatic invertebrates, and preparations thereof	25.84
00	Live animals other than animals of division 03	15.21

Source: WITS - World Bank based on TRAINS (SITC Revision 4).
Note: Average Most Favored Nation tariffs weighted by their corresponding trade value are used.

Table 3.2: List of Trade Agreements (As of 20 October 2020)

	Proposed/Under consultation and study	Negotiations launched	Signed but not yet In Effect	Signed and In Effect
Azerbaijan		• Iran PTA (2020).		• FTAs with Russia (1993), Moldova (1995), Georgia (1996), **Uzbekistan** (1996), Turkmenistan (1996), **Kazakhstan** (1997), **Kyrgyzstan** (2004), Belarus (2004), Ukraine (2006) and Tajikistan (2007). • Georgia, Ukraine, Azerbaijan, Moldova (**GUAM**) FTA (2006). • Economic Cooperation Organization Trade Agreement (2008). • PTA with Turkey (2021).
Kazakhstan	• Pakistan PTA (2003). • Shanghai Cooperation Organization FTA (2003). • EEU-Pakistan FTA (2015). • ASEAN-EEU FTA (2016). • EEU-Israel FTA (2016). • Indonesia-EEU FTA (2016). • Thailand-EEU FTA (2016). • Cambodia-EEU FTA (2017). • EEU-Mongolia FTA (2020).	• Customs Union of Russia, Belarus and Kazakhstan-EFTA FTA (2010). • Customs Union of Russia, Belarus and Kazakhstan-New Zealand FTA (2011). • India-EEU FTA (2015). • EEU - Egypt FTA (2016). • South Korea – EEU FTA (2017).	• China-EEU FTA (2018). • EEU-Singapore FTA (2019). • EEU-Serbia FTA (2019).	• **EEU Customs Union** (2010). • FTAs with Russia (1993), **Kyrgyzstan** (1995), **Azerbaijan** (1997), **Uzbekistan** (1997), Georgia (1999), Armenia (2001) and Ukraine (2008). • Economic Cooperation Organization Trade Agreement (2008). • **Commonwealth of Independent States Free Trade Area** (2012). • Vietnam-EEU FTA (2016). • EEU-Iran FTA (2019).
Kyrgyzstan	• Shanghai Cooperation Organization FTA (2003). • EEU-Pakistan FTA (2015). • EEU-Israel FTA (2016). • ASEAN-EEU FTA (2016). • Indonesia-EEU FTA (2016). • Thailand-EEU FTA (2016). • Cambodia-EEU FTA (2017). • EEU-Mongolia FTA (2020).	• India-EEU FTA (2015). • EEU - Egypt FTA (2016). • South Korea – EEU FTA (2017).	• China-EEU FTA (2018). • EEU-Singapore FTA (2019). • EEU-Serbia FTA (2019).	• **EEU Customs Union** (2015). • FTAs with Russia (1993), **Kazakhstan** (1995), Armenia (1995), Moldova (1996), **Uzbekistan** (1998), Ukraine (1998), **Azerbaijan** (2004) and Tajikistan (2006). • Economic Cooperation Organization Trade Agreement (2008). • **Commonwealth of Independent States Free Trade Area** (2012). • Vietnam-EEU FTA (2016). • EEU-Iran FTA (2019).
Turkey	• FTAs with African Caribbean Pacific Countries, Algeria, Canada, Central American Countries, India, Libya, South Africa USA and Vietnam.	• Active FTA negotiations with Indonesia, Japan, Somalia, Thailand and Ukraine. • Initiated FTA negotiations with Cameroon, Chad, Colombia, Democratic Republic of Congo, Djibouti, Ecuador, Gulf Cooperation Council, MERCOSUR, Mexico, Pakistan, Peru and Seychelles.	• FTAs with Lebanon (2013), Sudan (2017), Qatar (2018), United Kingdom (2020)	• **EU-Turkey Customs Union** (1996). • FTAs with EFTA (1992), Israel (1997), North Macedonia (2000), Bosnia and Herzegovina (2003), Tunisia (2005), Palestine (2005), Morocco (2006), Egypt (2007), Albania (2008), Georgia (2008), Montenegro (2010), Serbia (2010), Chile (2011), South Korea (2013), Mauritius (2013), Malaysia (2015), Moldova (2016), Faroe Islands (2017), Singapore (2017), Kosovo (2019) and Venezuela (2020).

Source: Asia Regional Integration Center; Ministry of Trade for the Republic of Turkey. *Note:* EEU - Eurasian Economic Union; FTA – Free Trade Agreement; PTA – Preferential Trade Agreement.

Bilateral Tariffs

Table 3.2 shows the list of trade agreements of the TC-4 countries. As part of the EEU Customs Union, Kazakhstan and Kyrgyzstan enjoy zero tariff rates in their trade with each other. Azerbaijan has free trade agreements with Kazakhstan, Kyrgyzstan and Uzbekistan. By the end of 2020, Turkey applied non-MFN tariffs to Azerbaijan, MFN tariffs to Kazakhstan, and preferential tariffs to Kyrgyzstan within the Generalized System of Preferences (GSP). It is expected for the signed preferential trade agreement between Turkey and Azerbaijan to enter into force in 2021.

Although bilateral tariffs between Azerbaijan, Kazakhstan, and Kyrgyzstan are virtually zero in almost all products, there are tariffs at varying levels in their trade relations with Turkey. In most products, tariffs applied to Turkey by Azerbaijan, Kazakhstan, and Kyrgyzstan are similar. The average weighted tariffs applied to all imported commodities from Turkey are lowest in Kyrgyzstan at 6.15%, followed by Kazakhstan (6.64%) and Azerbaijan (10.1%). Average tariffs applied by Turkey to all commodities from the remaining TC-4 countries are the lowest for Kazakhstan at 2.58%, for Azerbaijan at 3.36%, and for Kyrgyzstan at 7.89% (Table-3.3).

Fish, meat and meat preparations, and vegetables and fruit are the product groups that Turkey executes the highest import restrictions from other TC-4 countries. In the case of fish, crustaceans, molluscs product group, Turkey's tariffs go to 81.9% for Azerbaijan and 56.31% for Kazakhstan. For Kyrgyzstan, Turkey has introduced the highest tariffs for "miscellaneous edible products and preparations" product category at 39% (Table-3.3).

The highest tariffs applied by Azerbaijan for Turkish products listed in Table-3.3 are at 15%. Sugars, travel goods, and articles of apparel are categories where Turkish products face the highest average tariffs of Kazakhstan at around 12.50%. Meat and meat preparations and tobacco and tobacco manufactures are the top products with the highest tariff rates for Turkish exports to enter the Kyrgyz market, with tariff rates of 52.5%, and 15%, respectively.

Table 3.3: Top 10 Products with Highest Average Tariffs Applied Among TC-4 Countries (2019)

Turkey to Azerbaijan		Turkey to Kazakhstan	
Product Name	**Weighted Average**	**Product Name**	**Weighted Average**
All Commodities average	*3.63*	*All Commodities average*	*2.58*
Fish (not marine mammals), crustaceans, molluscs	81.9	Fish (not marine mammals), crustaceans, molluscs	56.31
Meat and meat preparations	53.91	Cereals and cereal preparations	45.24
Vegetables and fruit	36.07	Coffee, tea, cocoa, spices, and manufactures	20,0
Tobacco and tobacco manufactures	25,0	Vegetables and fruit	16.44
Fixed vegetable fats and oils, crude, refined	22.57	Footwear	16.08
Live animals other than animals of div. 03	13.21	Crude animal and vegetable materials, n.e.s.	15.89
Road vehicles (including air-cushion vehicles)	12.6	Articles of apparel and clothing accessories	11.9
Articles of apparel and clothing accessories	12,0	Oil-seeds and oleaginous fruits	7.05
Non-metallic mineral manufactures, n.e.s.	10.48	Iron and steel	5.51
Iron and steel	10.13	Plastics in non-primary forms	5.38

Turkey to Kyrgyzstan		Azerbaijan to Turkey	
Product Name	**Weighted Average**	**Product Name**	**Weighted Average**
All Commodities average	*7.89*	*All Commodities average*	*10.01*
Miscellaneous edible products and preparations	39.01	Meat and meat preparations	15,0
Vegetables and fruit	14.72	Dairy products and birds & eggs	15,0
Textile yarn, fabrics, made-up articles, n.e.s.	12,0	Coffee, tea, cocoa, spices, and manufactures	15,0
Footwear	8.84	Tobacco and tobacco manufactures	15,0
Organic chemicals	5.5	Gas, natural and manufactured	15,0
Miscellaneous manufactured articles, n.e.s.	5.46	Animal oils and fats	15,0
Crude animal and vegetable materials, n.e.s.	5.12	Essential oils and resinoids and perfume materials	15,0
Plastics in primary forms	4.59	Leather, leather manufactures, n.e.s., and dressed	15,0
Road vehicles (including air-cushion vehicles)	3.88	Travel goods, handbags and similar containers	15,0
Electrical machinery, apparatus and appliances	3.17	Articles of apparel and clothing accessories	15,0

Kazakhstan to Turkey		Kyrgyzstan to Turkey	
Product Name	**Weighted Average**	**Product Name**	**Weighted Average**
All Commodities	*6.51*	*All commodities average*	*6.15*
Sugars, sugar preparations and honey	12.65	Meat and meat preparations	52.5
Travel goods, handbags and similar containers	12.58	Tobacco and tobacco manufactures	15,0
Articles of apparel and clothing accessories	12.44	Travel goods, handbags and similar containers	12.63
Road vehicles (including air-cushion vehicles)	11.08	Sugars, sugar preparations and honey	12.43
Non-metallic mineral manufactures, n.e.s.	10.84	Dairy products and birds & eggs	12.39
Miscellaneous edible products and preparations	10.83	Textile fibres (other than wool tops and other combed wool)	11.89
Manufactures of metals, n.e.s.	9.94	Articles of apparel and clothing accessories	11.44
Cereals and cereal preparations	9.31	Non-metallic mineral manufactures, n.e.s.	10.31
Beverages	9.23	Animal oils and fats	10,0
Photographic apparatus, equipment and supplies	8.84	Miscellaneous edible products and preparations	9.83

Source: WITS - World Bank based on TRAINS (SITC Revision 4, 2-digit).
Note: Average Most Favored Nation tariffs weighted by their corresponding trade value are used.

Non-Tariff Measures

Regional integration efforts worldwide reduce the barriers to trade across the borders. In many cases, tariff measures do not constitute a major barrier for traders any longer. The ability to benefit from market access depends increasingly on compliance with trade regulatory measures, or Non-Tariff Measures (NTMs), such as sanitary and technical standards for goods. Such measures are becoming a growing challenge for exporters, importers, and policymakers. Thereby, they are increasingly shaping trade, influencing who trades what and how much.

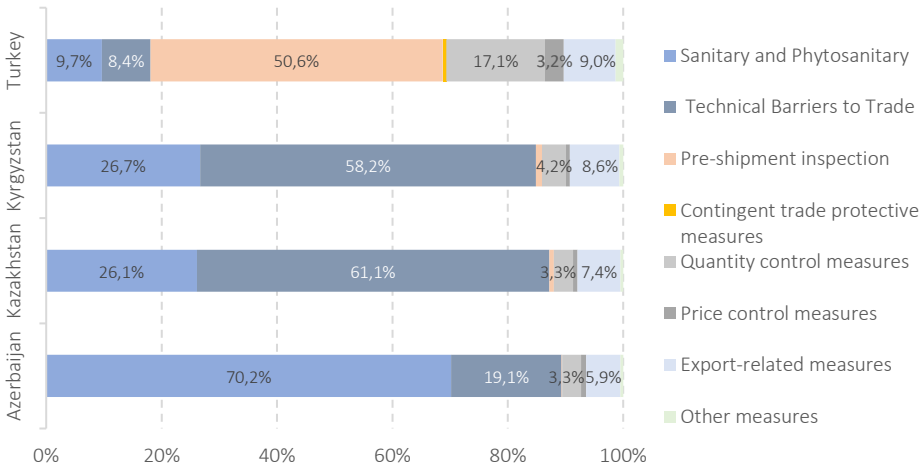
UNCTAD defines NTMs as “policy measures, other than customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both” (UNCTAD, 2009). The International Classification of NTMs distinguishes at the most detailed level 177 types of measures (UNCTAD, 2013). Many NTMs aim primarily to protect public health or the environment (Sanitary and Phytosanitary measures and Technical Barriers to Trade). They also substantially affect trade through information, compliance, and procedural costs. Due to their critical primary objectives, some measures such as protecting

health or the environment cannot entirely be eliminated. Other trade and trade-related policies include price and quantity measures, licensing requirements, subsidies, competition-related policies, and export measures. Some of these non-technical measures can be used by some countries to discourage foreign producers from entering domestic markets.

To allow for systematic monitoring and analysis of NTMs applied by countries, the UNCTAD maintains a continuously updated global database of NTMs within their TRAINS portal. Due to the different nature of measures and different countries' legal structures, the total number of NTMs imposed by countries cannot be compared. Still, for informative purposes, it should be noted that by the end of 2020, the total number of NTMs was at 632 in Kazakhstan, 596 in Kyrgyzstan, and 310 in Turkey. As of August 2019, the total number of NTMs in Azerbaijan was at 393.

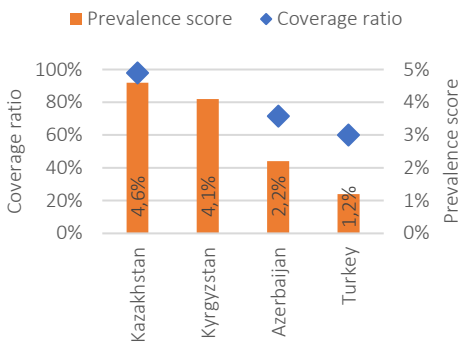
Most NTMs in TC-4 countries are technical measures, precisely, sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT) (see Figure 3.2). SPS measures in Azerbaijan are significantly more prevalent at 70% versus near 26% in Kazakhstan and Kyrgyzstan, and 9.7% in Turkey. On the other hand, the share of TBT measures in Kazakhstan is 61.1%, which is higher than the average percentage of TBTs in Kyrgyzstan, Azerbaijan, and Turkey (58.2%, 19.1%, and 9.7%, respectively). In Turkey, shares of pre-shipment inspection measures (50.6%) and quantity control measures (17.1%) are more significant than the rest. The share of export measures in Azerbaijan (5.9%) is lower than in Turkey (9%), Kyrgyzstan (8.6%), and Kazakhstan (7.4%).

Figure 3.2: Shares of Non-tariff Measures by Type (2020, percent)



Source: UNCTAD TRAINS database as accessed in 26 December 2020; UN ESCAP, "Non-tariff Measures in Azerbaijan and their Linkages to the Sustainable Development Goals", *Policy Brief*, 7 November 2019.
Note: Data for Azerbaijan as of August 2019.

Figure 3.3: Coverage ratios and prevalence scores of NTMs (2020, percent)



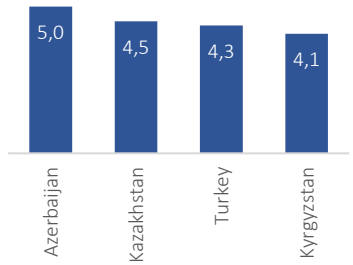
Source: UNCTAD TRAINS database as accessed in 26 December 2020; UN ESCAP, "Non-tariff Measures in Azerbaijan and their Linkages to the Sustainable Development Goals", *Policy Brief*, 7 November 2019.
Note: Data for Azerbaijan as of August 2019.

Two descriptive indicators commonly used to quantify the intensity of NTMs are coverage ratio and prevalence score. The coverage ratio captures how much of an economy's trade are subject to NTMs. The prevalence score indicates how many distinct NTMs are applied to regulated products, on average.

As shown in Figure 3.3, Kazakhstan has a coverage ratio of 98%, Azerbaijan 72%, and Turkey 60% (coverage ratio for Kyrgyzstan is not available). The prevalence score of above 4% for Kazakhstan and Kyrgyzstan is higher than Azerbaijan's prevalence scores (2.2%) and Turkey (1.2%).

Another database that covers statistics on NTMs is the WEF Global Competitiveness Index. It asks explicitly in surveys, "to what extent do non-tariff barriers (e.g., health and product standards, technical and labeling requirements, and the like) limit the ability of imported goods to compete in the domestic market?" Scores are on the scale from 1 to 7, with higher values indicating more substantial limitation by NTMs. Values from this database are presented in Figure 3.4, where Azerbaijan in 2019 appears with the highest non-tariff barriers score at 5. It is followed by Kazakhstan (4.5) and Turkey (4.3). The lowest restrictions are found to be in Kyrgyzstan (4.1).

Figure 3.4: Prevalence of Non-Tariff Barriers (2019)



Source: WEF Global Competitiveness Index.

Due to data limitations, it was not possible to review the bilateral NTMs. Still, analyses on non-tariff barriers show significant impediments against free trade flows due to non-tariff measures applied by the TC-4 countries. Some of these measures are probably necessary for various health and environmental reasons. However, their applications should not discourage trade relations among the Member States.

3.3 Trade Costs and Customs Procedures

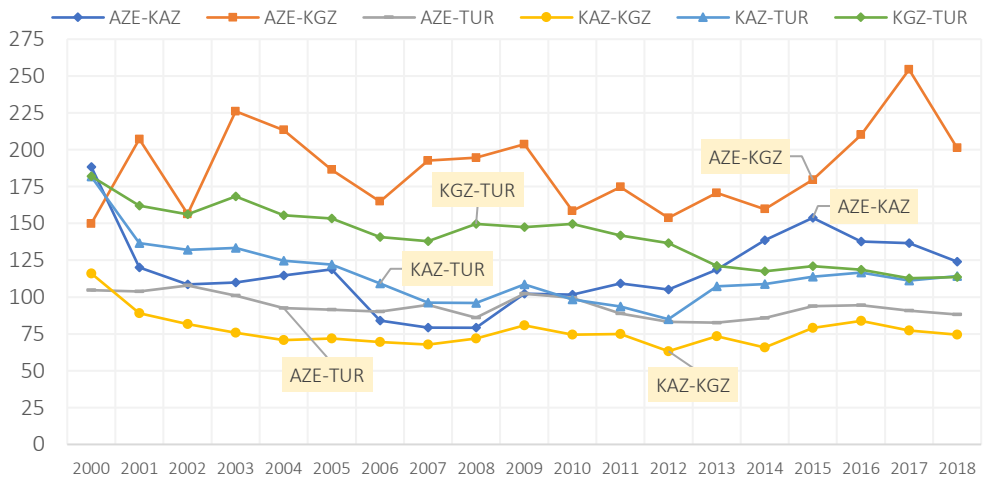
Since the initiation of the General Agreement on Trade and Tariffs in 1947, a dramatic fall in tariffs was observed in the world trading system. Particularly in manufactured goods, significant reductions were observed in tariff rates. Substantial improvements in transport and

logistics have also contributed to the fall in trade costs around the world. However, international trade remained to be more costly than domestic trade. This is due to costs of transporting goods to far distances and at-the-border and behind-the-border costs that can be reduced by appropriate policies. This fact has accordingly shifted the attention from reducing policy barriers to promoting trade facilitation.

According to the World Bank and UNESCAP research, trade costs are influenced to varying degrees by distance and transport costs, tariff and non-tariff measures, and logistics. The data also stress the importance of supply chains and connectivity constraints in explaining the higher costs and lower trade integration levels observed in developing countries.

Trade costs broadly include all costs incurred in getting a product to a final user other than the marginal cost of producing the product itself: transportation costs (both freight costs and time costs), policy barriers (tariffs and non-tariff barriers), information costs, contract enforcement costs, costs associated with the use of different currencies, legal and regulatory costs, and local distribution costs (wholesale and retail) (Anderson and van Wincoop, 2004). Therefore, in an increasingly globalized and networked world, trade costs matter as a determinant of the pattern of bilateral trade and investment, as well as of the geographical distribution of production. Trade costs are an essential determinant of a country's ability to participate in regional and global production networks (Arvis et al., 2013).

Figure 3.5: Trade Costs among TC-4 Countries (Percent, 2000-2018)



Source: ESCAP-WB Trade Costs database.

Figure 3.5 shows the trend in bilateral trade costs among the TC-4 economies. In most cases, the trade costs remain stable over the years, despite some fluctuations. The most considerable trade costs are observed between Azerbaijan and Kyrgyzstan and it is almost continually rising for the last several years. In 2018, bilateral trade costs between Azerbaijan and Kyrgyzstan were estimated at 201% ad valorem, which means that an additional cost of near two times

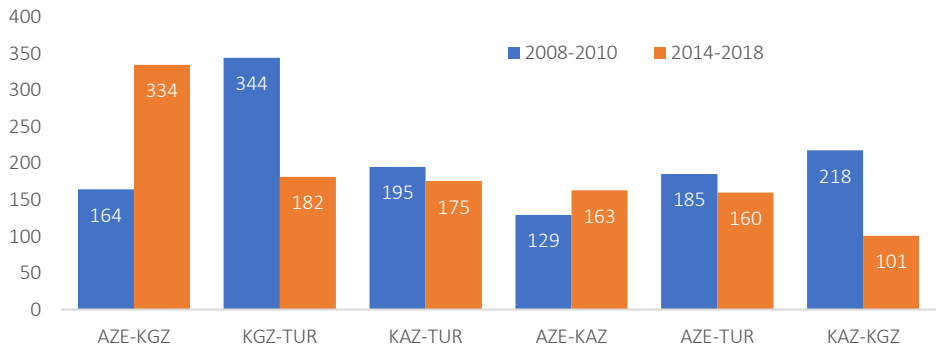
the original value of commodities were incurred in their shipment from producers to local customers.

Trade costs between Azerbaijan and Kazakhstan have more than doubled between 2008 and 2015 by increasing from 79% to 154%. After 2015, trade costs between these two countries started to decrease, reaching 124% in 2018. However, this value remains the second most costly trade relation within the TC-4 group.

Azerbaijan's trade costs with Turkey are at a considerably lower level. It generally fluctuates between 80%-100%, and as of 2018, it stands at 88%. The lowest trade costs are observed between Kazakhstan and Kyrgyzstan. Geographic proximity plays a significant role in low trade costs. As of 2018, total trade costs between the two countries are estimated at 75% ad valorem. Trade costs between Turkey and Kazakhstan and Turkey and Kyrgyzstan stood at near 113% in 2018.

Due to higher protectionism and the perishable nature of agricultural sector products, trade costs for agricultural products are higher than manufactured goods. Figures 3.6 and 3.7 compares the agricultural and manufacturing sector trade costs among TC-4 economies for the periods 2008-2010 and 2014-2018. In agricultural products, trade costs in all bilateral relations have declined during the two periods under consideration. The highest trade costs in agriculture are observed between Azerbaijan and Kyrgyzstan, estimated to be 338% in 2018. Agricultural trade costs between Azerbaijan-Kazakhstan, Azerbaijan-Turkey, Kazakhstan-Turkey, and Kyrgyzstan-Turkey are close to each other, around 160%-182% for the period from 2014 to 2018. The lowest trade costs in agriculture were recorded in trade between Kazakhstan and Kyrgyzstan, which was estimated to be 101% for the same period.

Figure 3.6: Trade Costs among TC-4 in Agriculture (Percent, 2000-2018)

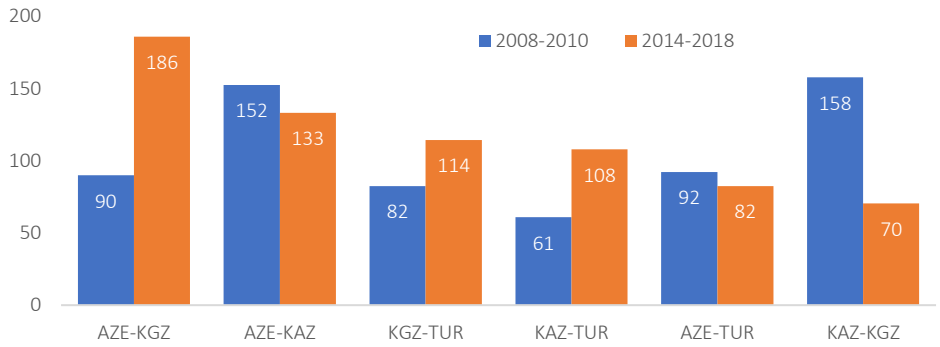


Source: ESCAP-WB Trade Costs database.

Regarding trade costs in manufacturing goods, bilateral trade costs have increased over the two-period under consideration except for two cases. The largest increase was observed in Azerbaijan and Kyrgyzstan's case, which increased from 90% in 2008-2010 to 186% in 2014-2018. This is also the highest rate of bilateral trade costs in manufacturing goods among TC-4.

Trade costs between Turkey and Kazakhstan and Turkey and Kyrgyzstan also increased substantially in the observed period (Figure 3.7). A substantial decrease in manufacturing trade cost was estimated for the Kazakhstan-Kyrgyzstan case, where costs decreased from 158% to 70%. Trade costs in manufactured goods between Kazakhstan and Kyrgyzstan appears as the lowest among the TC-4 countries.

Figure 3.7: Trade Costs among TC-4 in Manufacturing (Percent, 2000-2018)



Source: ESCAP-WB Trade Costs database.

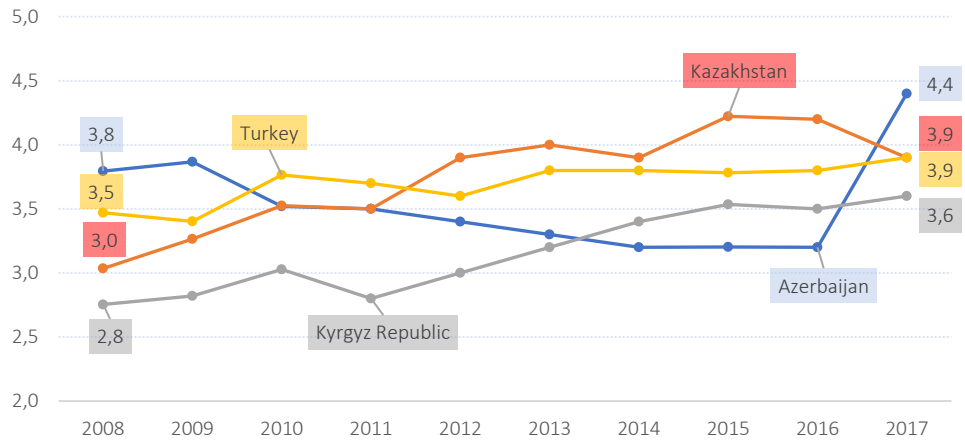
Given that a significant share of trade between TC-4 countries is composed of primary and agricultural products, the fall in trade costs is expected to ease trade flows. Overall, it is promising to observe a fall in trade costs in agricultural products. However, on average, agricultural goods' trade costs are 38% higher than the trade cost of manufactured goods. Further, it is quite worrisome to see rising trade costs in manufacturing goods in some bilateral cases. These trade costs constitute a setback for intra-regional trade improvement, which should be addressed by the Turkic Council.

Custom Procedures

As briefly discussed earlier, trade costs include all costs incurred in getting a good to a final user other than the cost of producing the good itself, including transportation costs and trade barriers. Custom procedures play a significant role in reducing trade costs and facilitating trade flows. In many cases, importers report high costs for customs clearance, a lack of transparency and information from customs authorities, and arbitrary interpretation of customs clearance requirements at the border.

Figure 3.8 shows the burden of customs procedures in TC-4 countries. There has been some progress in improving custom procedures' efficiency over the period from 2008 to 2017. The custom procedures in Azerbaijan have been deteriorating up until 2016. However, significant improvement is recorded in 2017, making Azerbaijan's customs procedures most efficient among TC-4 countries. Kazakhstan and Turkey had the same scores for the burdensome of custom procedures in 2017 (3.9). In the same year, Kyrgyzstan attained 3.6 points out of 7 for the efficiency of its customs.

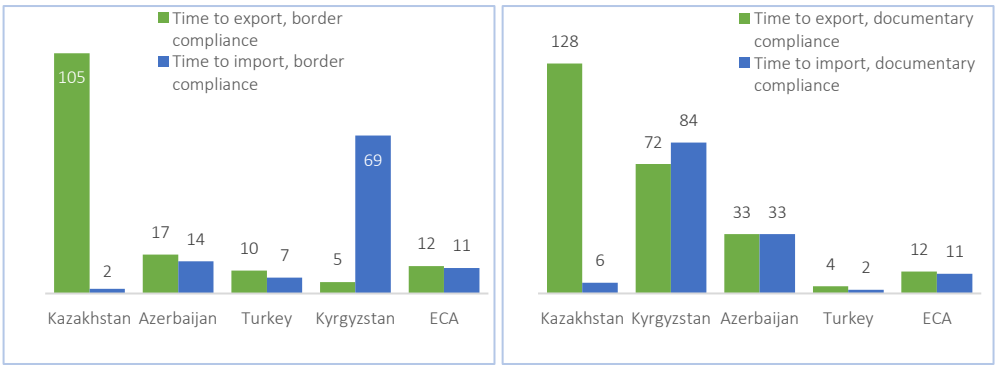
Figure 3.8: Burden of Customs Procedure
(Scores on the scale from 1=extremely inefficient to 7=extremely efficient)



Source: WB WDI database based on WEF.

To better understand the TC-4 customs procedures, Figures 3.9-3.10 depicts the time and costs for border and documentary compliance. Figures also include average values for Europe and Central Asia (ECS) for comparison purposes. There are diverging practices at the border crossings. In 2019 it took on average 105 hours in Kazakhstan to complete border compliances when exporting products from the country. However, it took only 2 hours for import (Figure 3.9). There was an opposite case in Kyrgyzstan. It took 5 hours to complete border compliances for export, but 69 hours for import. This implies that an exporter from Kazakhstan to Kyrgyzstan had required 174 hours to complete border compliances in 2019. Border compliances in Azerbaijan are close to the ECS average and in Turkey shorter than the ECA average.

Figure 3.9: Time Required for Border and Documentary Compliance
(Hours, 2019)

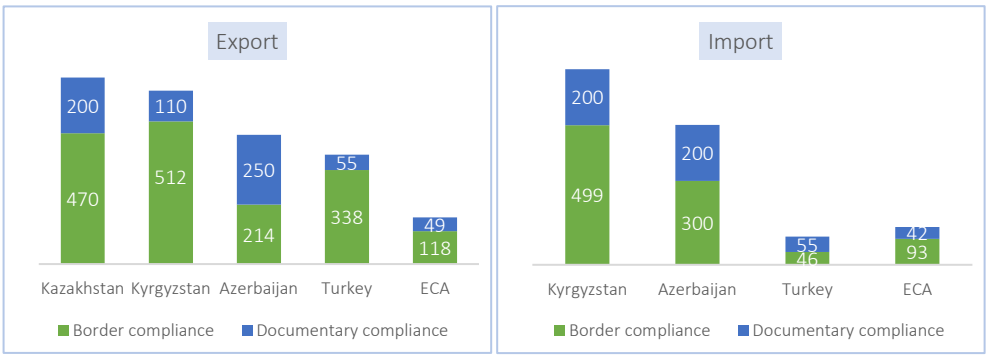


Source: WB WDI database. *Note:* ECA - Europe and Central Asia

A similar picture is observed in the time required to complete documentary compliance. It takes 128 hours in Kazakhstan to complete documentary compliance for exporters, but only 6 hours for importers (Figure 3.9). In Azerbaijan, both exporters and importers require, on average, 33 hours to complete documentary compliance. Turkey has the lowest time required for documentary compliance, which is also below the ECA average.

In terms of export and import costs, it is observed that in 2019 the highest costs were incurred in Kazakhstan and Kyrgyzstan when exporting and Kyrgyzstan and Azerbaijan when importing (Figure 3.10, data for costs to import to Kazakhstan is not available). Costs to import in Turkey were below the ECA region's average in 2019, whereas the costs to export and import were significantly higher in the rest of the TC-4 countries.

Figure 3.10: Costs to Export and Import (2019, $US)



Source: WB WDI Database.
Note: ECA - Europe and Central Asia. Costs to import data for Kazakhstan not available.

3.4 Trade Facilitation

Trade facilitation is defined by the World Trade Organization (WTO) as the simplification and harmonization of international trade procedures, including the activities, practices, and formalities involved in collecting, presenting, communicating, and processing data and other information required for the movement of goods in international trade. More generally, trade facilitation refers to the ease of moving goods across borders through efficient customs administration, quality physical infrastructure, and a competitive logistics sector.

Over the last decade, it has gained prominence in the international political agenda, culminating in an agreement at a global level. Trade Facilitation Agreement (TFA) of WTO entered into force in February 2017, which contains provisions for expediting the movement, release, and clearance of goods, including goods in transit. It also sets out effective cooperation measures between customs and other appropriate authorities on trade facilitation and customs compliance issues. It further contains provisions for technical assistance and capacity building in this area. According to WTO estimations, the full implementation of the TFA could reduce trade costs by an average of 14.3% and boost global

trade by up to $1 trillion per year, with the most significant gains in the poorest countries (WTO, 2016).

Significant progress has been made in the agreement's implementation, and 62.5% of commitments are implemented as of July 2019. Three members of the WTO from the TC-4 group show different patterns. While Turkey implemented all its commitments, Kazakhstan implemented 44.5%, and Kyrgyzstan only 12.2% (Table 3.4).

Table 3.4: Rate of Implementation Commitments (2019)

	Kazakhstan	Kyrgyzstan	Turkey
Rate of implementation commitments to date across categories	44,5%	12,2%	100%
Rate of implementation commitments by December 2023 without capacity building support	23,5%	16,4%	
Rate of implementation commitments by December 2023 upon receipt of capacity building support	32,4%	71,4%	

Source: TFA Database, WTO.

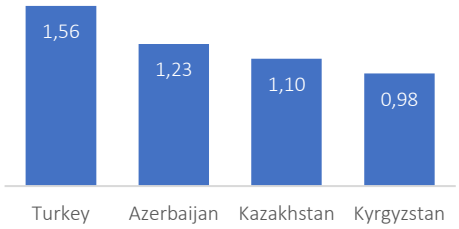
Lack of transparency about rules and regulations, redundant and prolonged clearance processes, and multiple document requirements in different formats and different data elements increase the costs and time of doing trade. Today these impediments are seen as posing more significant trade barriers than tariffs and quotas (UNECE, 2019). Therefore, it is critical to achieve trade facilitation to enhance administrative efficiency and effectiveness, reduce costs and time to markets, and increase global trade predictability.

To increase trade among the Turkic Council Member States, special attention should be paid to trade facilitation. This is required to connect with regional supply and value chains and become part of sourcing, production, and distribution networks. It is beyond the capacity of this report to deliberate on specific trade facilitation measures. However, to assess the performance of the TC-4 countries and identify the needs for further improvement, global databases are used.

A comprehensive toolkit and database developed by OECD allow the assessment of the state of play on trade facilitation across more than 160 countries. The Trade Facilitation Indicators (TFI) of OECD are composed of a set of variables measuring the actual extent to which countries have introduced and implemented trade facilitation measures. The TFIs are not designed to assess country compliance with specific TFA provisions of WTO, but rather to help policymakers to evaluate the state of their trade facilitation efforts, pinpoint challenges, and identify opportunities for progress (see OECD 2018 for further information).

Eleven TFIs take values from 0 to 2, where 2 designates the best performance that can be achieved. Figure 3.11 shows the average trade facilitation performance of TC-4 countries.

Figure 3.11: Average Trade Facilitation Performance (2019)



Source: OECD.

Turkey had the highest score with 1.56 in 2019, indicating that it made the most progress in facilitating trade. With an average score of 1.23, Azerbaijan shows a moderate performance in trade facilitation. Kazakhstan and Kyrgyzstan need to focus more on specific aspects of trade facilitation to improve their overall trade facilitation performance.

Evaluation at the level of specific trade facilitation indicators shows that in 2019, external and internal border agency cooperation was, on average, the weakest point of TC-4 countries in terms of trade facilitation. Turkey performs better than the remaining TC-4 countries in seven indicators (Figure 3.12). The highest performance of Turkey is observed in the governance and impartiality (1.89). Turkey could tap into potentials of higher trade flows and lower trade costs by encouraging the advance rulings systems' use, expanding the Single Window coverage.

Azerbaijan performed relatively better in governance and impartiality (1.56) and information availability (1.48) in 2019. The weakest indicators were external border agency cooperation (0.80), internal border agency cooperation (0.90), documents (1.13), and involvement of the trade community (1.14). To reach its best performance, Azerbaijan needs to reduce the average clearance time, introduce pre-arrival processing of import documentation, and further simplify procedures and documentation in terms of associated time and costs and harmonize them following international standards.

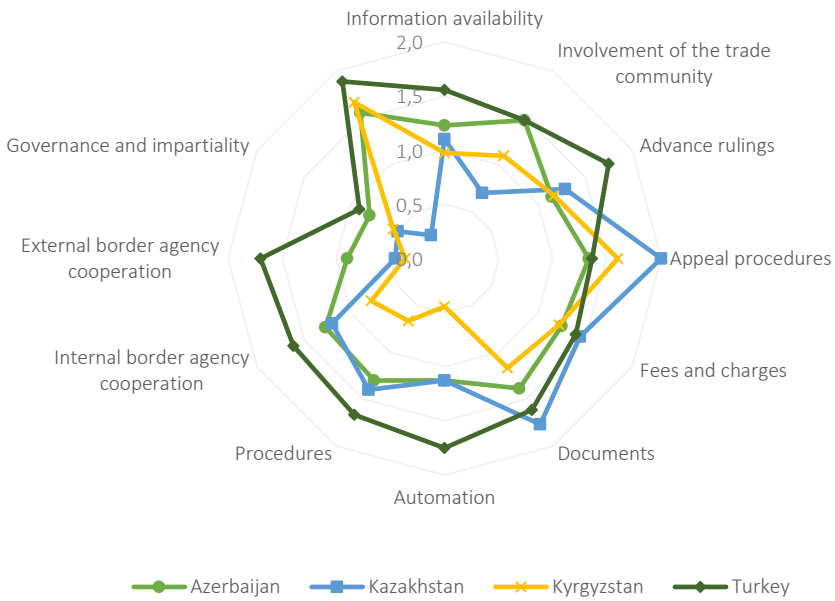
Kazakhstan showed the strongest performance in advance rulings (2.0) and fees and charges indicator (1.77) compared to other TC-4 countries. However, in 2019, Kazakhstan had challenges in the areas of governance and impartiality (0.25), internal border agency cooperation (0.46), and external border agency cooperation (0.50). Information availability (0.70), documents (1.13), and procedures (1.20) also require attention for further improvement in Kazakhstan (Figure 3.12). The performance gaps in these areas are huge compared to Turkey and other OECD countries. For Kazakhstan to reach the best performance in these areas, it needs to reduce the number of documents required for import and export and the time necessary to prepare such documents, lower the number and types of fees and charges collected, complete the development of the Single Window, and reduce the average clearance time.

As a lower-middle-income country, Kyrgyzstan could make substantial progress by narrowing the gaps in trade facilitation indicators. In 2019, Kyrgyzstan had the highest score in governance and impartiality (1.67) and performed relatively well in advance rulings (1.60), which reflects the country's capability in reaching the best performance. However, major challenges were apparent in internal border agency cooperation (0.36), documents (0.44), external border agency cooperation (0.55), automation (0.67) and procedures (0.78). In this

connection, Kyrgyzstan should reduce the number of documents required for import and export and the time necessary to prepare such documents, improve IT systems' capacity to exchange data electronically, and consider a Single Window development and expand cooperation with internal and external border agencies.

Source: OECD Trade Facilitation Indicators, as accessed on 27 December 2020.

Figure 3.12: Trade Facilitation Indicators (2019)



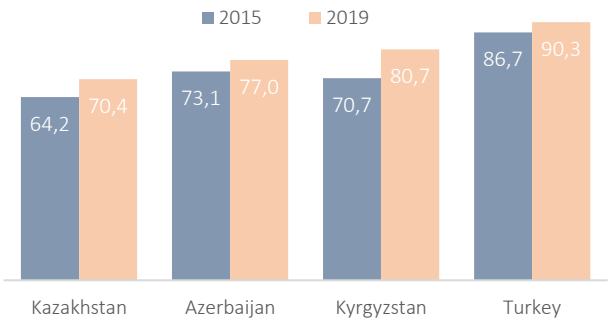
Information availability: Enquiry points; publication of trade information, including on the Internet.
Involvement of the trade community/consultations: Structures for consultations; established guidelines for consultations; publications of drafts; the existence of notice-and-comment frameworks.
Advance rulings: Prior statements by the administration to requesting traders concerning the classification, origin, valuation method, etc., applied to specific goods at the time of importation; the rules and process applied to such statements.
Appeal procedures: The possibility and modalities to appeal administrative decisions by border agencies.
Fees and charges: Disciplines on the fees and charges imposed on imports and exports; disciplines on penalties.
Formalities-Documents: Acceptance of copies, simplification of trade documents; harmonization in accordance with international standards.
Formalities-Automation: Electronic exchange of data; use of automated risk management; automated border procedures; electronic payments.
Formalities-Procedures: Streamlining of border controls; single submission points for all required documentation - single windows; post-clearance audits; authorized operators.
Internal border agency cooperation: Control delegation to Customs authorities; cooperation between various border agencies of the country.
External border agency cooperation: Cooperation with neighboring and third countries; alignment of procedures and formalities; coordination/harmonization of data requirements and documentary controls; risk management cooperation; joint controls.
Governance and impartiality: Customs structures and functions; accountability; ethics policy.

Evidently, there are some common challenges faced by TC-4 countries in facilitating trade. Internal border agency cooperation is among the weakest indicators of trade facilitation within

the TC-4, indicating low levels of control delegation to customs agencies and lack of collaboration between various country border agencies. Effective communication among border agencies would increase operational efficiency and facilitate legitimate trade by removing redundant or sequential controls and duplicative documentation requirements (OECD, 2018). This could be achieved through open communication amongst relevant agencies, supported by clear delineation of responsibilities and clear frameworks for data sharing.

Cooperation with border agencies in neighboring and third countries is even more challenging than domestic border agency cooperation. External data harmonization, external formalities alignment, external risk coordination, external sharing control results, joint controls, and common facilities are some of the missing dimensions of cross-border coordination to facilitate intra-regional trade.

Figure 3.13: Trading Across Borders



Source: World Bank Doing Business database.

The World Bank's Doing Business (DB) project provides business regulations measures and their enforcement across 190 economies and selected cities at the subnational and regional level. A component of the DB is the trading across borders indicator, where the time and cost associated with the logistical process of exporting and importing goods are recorded. DB measures the time and cost (excluding tariffs) associated with three sets of procedures—documentary compliance, border compliance, and domestic transport—within the overall exporting or importing of a shipment of goods. Depending on the data's impact, specific changes are classified as reforms and listed in the summaries of DB reforms in the next edition of the report to acknowledge the implementation of significant changes.

Figure 3.13 shows TC-4 countries' progress in improving their trading across borders performance between 2015 and 2019 (comparison with earlier results is impossible due to a change in DB methodology). All countries under consideration managed to improve their trading across borders thanks to a series of reforms undertaken. Figure 3.14 summarizes the policy reforms that are found to be essential to be included in the respective DB reports since 2008. Every country introduced new measures to facilitate trade across borders through various reforms. Continuation of this trend will facilitate trade among the TC-4 and other countries as well.

Figure 3.14: Achievements by TC MCs in Improving Trade across Borders

2008-2010	2011-2015	2017	2019
• [2008] Turkey made trading across borders easier by introducing an electronic data interchange system, improving information technology infrastructure and training some 2,500 customs officers and 14,000 traders. • [2010] Azerbaijan reduced the clearance and border crossing time for goods by streamlining and regrouping agencies behind a single customs service window. • [2010] The Kyrgyz Republic made trading across borders easier and less time consuming by eliminating some previously required documents and simplifying inspection procedures.	• [2011] Kazakhstan speeded up trade through efforts to modernize customs, including implementation of a risk management system and improvements in customs automation. • [2014] Azerbaijan made trading across borders easier by streamlining internal customs procedures. • [2015] Kazakhstan made trading across borders easier by opening a new border station and railway link that helped reduce congestion at the border with China.	• Azerbaijan facilitated international trade processes by introducing an electronic system for submitting export and import declarations. • Kazakhstan made exporting less costly by removing two export documents required for customs clearance. • The Kyrgyz Republic decreased time and cost for exporting by becoming a member of the Euroasian Economic Union.	• Azerbaijan made trading across borders faster by streamlining electronic customs procedures and fully implementing the "green corridor" gating system. • Kazakhstan made trading across borders easier by introducing an electronic customs declaration system, ASTANA-1 IS, as well as reducing customs administrative fees. • The Kyrgyz Republic made trading across borders easier by streamlining exports within the Eurasian Economic Union. • Turkey reduced the time and cost to export and import through various initiatives, including expanding the functionalities of the national trade single window, enhancing the risk management system and lowering customs brokers' fees.

Source: World Bank.

Logistics Performance Index

Trade facilitation is highly interconnected with logistical infrastructure and facilities. A standard indicator to measure logistics performance is the Logistics Performance Index (LPI) of the World Bank. The LPI is based on a worldwide survey of operators on the ground, providing feedback on the logistics "friendliness" of the countries they operate and those they trade.

The overall assessment of LPI shows that Turkey has better logistics performance than other TC-4 countries (Figure 3.15). However, its performance is declining since 2014 and fell below the average of Europe and Central Asia. Kazakhstan has been improving its performance since 2012, which reached 2.8 in 2018. Noting that the data for Azerbaijan is available only until 2014, its performance remains below Kazakhstan. Within the LPI sub-components, competence and quality of logistics services also remain mostly moderate and below the ECS average (Figure 3.16). Turkey again outperforms other TC-4 countries, but remains below the average of ECS.

Figure 3.15: Logistics Performance Index, Overall Score

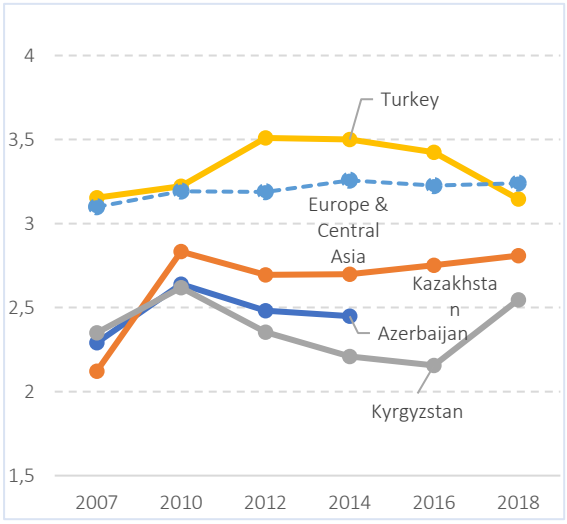
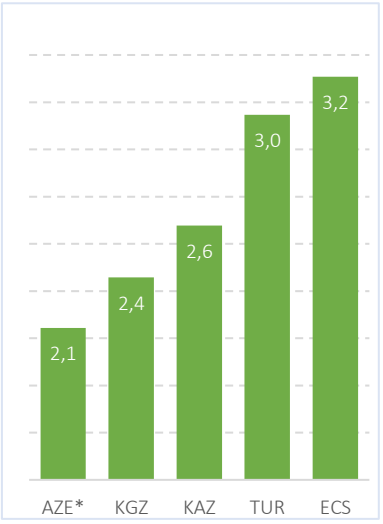


Figure 3.16: LPI-Competence and Quality of Logistics Services (2018)



Source: World Bank LPI database.
Note: 1=low to 5=high; (*) 2014 data; ECS - Europe and Central Asia

Another sub-component of the LPI is the efficiency of the customs clearance process and the quality of trade and transport-related infrastructure. In both of these indicators, Turkey has been attaining higher scores compared to other countries.

Figure 17: LPI -Efficiency of Customs Clearance Process

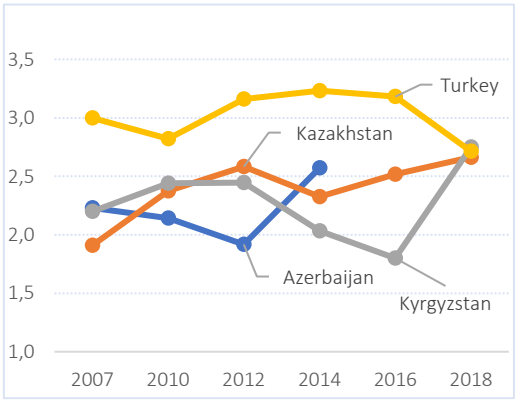
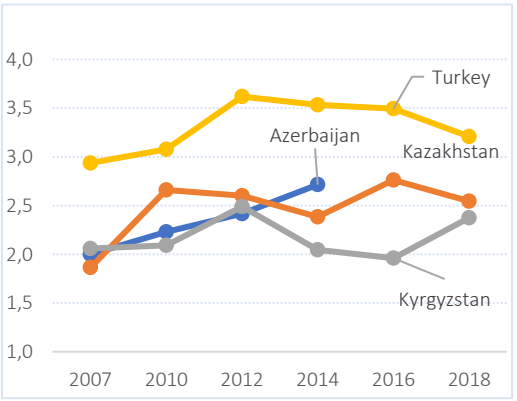


Figure 18: LPI - Quality of Trade and Transport-Related Infrastructure



Source: World Bank LPI database; *Note:* 1=low to 5=high.

CHAPTER

IV

Analysis of Intra-Regional Trade Potential

4 Analysis of Intra-Regional Trade Potential

Turkic Council Member States have commonalities in many areas that would positively affect the intra-regional economic and commercial cooperation. However, various factors lead to underutilization of potential economic partnership opportunities within the region. This section attempts to identify the trade potentials among the TC-4 countries and analyze the potential impacts of greater economic cooperation on the bilateral trade flows.

4.1 Trade Potentials among the Turkic Council Countries

There is a strong correlation and interdependence between trade and economic growth. Exports increase local firms' exposure to international competition and force them to learn state-of-the-art technology and systems and engage in innovative approaches. Greater capacity to export support job creation and income generation in a country.

Multilateral and bilateral liberalization over the past decades led to a significant reduction in trade barriers and the rise of global value chains. However, many countries still struggle to integrate with regional and international partners to have improved trade relations. There are substantial trade potentials that remain untapped by many countries, including the TC-4. Whatever the reasons might be, it is highly advisable to develop partnership strategies to utilize existing export potentials, thereby supporting national development and regional integration efforts.

The Export Potential Indicator (EPI) developed by the International Trade Centre (ITC) is used to identify the export potential among the TC-6. The EPI calculates a benchmark trade value in dollar terms that can be compared with actual export values in order to find opportunities for additional export growth across existing and new target markets. This untapped export potential may reflect several underlying causes, including a lack of knowledge or difficulties in complying with market entry requirements, consumer preferences, quality considerations, and competition policies. Specific buyer requirements within international value chains may be another reason why exports to a particular market are significantly below the estimated potential. Potential values should be understood as a typical value of trade flows given a country's export performance and a target market's demand, both projected into the short-term future. While exports to some markets may be well below their potential, exports to other, often traditional markets may exceed their potential.

The ITC follows a quantitative approach to identify promising export sectors and markets globally, based on tangible and measurable trade and market access data and information. Unmeasurable or intangible factors and recent events affecting bilateral and multilateral relations could affect the calculated export and diversification measures. Thus, the

prioritization of products and markets is not taken into consideration due to their immeasurability. The EPI thereby identifies products in which the exporting country has already proven to be internationally competitive and has good prospects of export success in new or existing target markets. The EPI also helps to identify niche products of sectors that are not on top of the ranking but could allow for more trade, economic development or poverty reduction. There are also significant gaps between what countries could export and what they actually export.

Table 4.1: Untaped Export Potential (2019, million $US)

Reporter	Partners		
Azerbaijan	*Kazakhstan*	*Kyrgyzstan*	*Turkey*
	21,8	3,7	88,6
Kazakhstan	*Azerbaijan*	*Kyrgyzstan*	*Turkey*
	34	48,7	577,6
Kyrgyzstan	*Azerbaijan*	*Kazakhstan*	*Turkey*
	4,6	60,3	21,4
Turkey	*Azerbaijan*	*Kazakhstan*	*Kyrgyzstan*
	569,4	755,9	478,6

Source: International Trade Centre, Export Potential Map. Data as accessed on 27 December 2020

Table 4.1 shows the gap between what TC-4 countries intra-regionally could export, and they actually export. Azerbaijan has the largest untapped export potential with Turkey. In 2019, Azerbaijan could export more than $88 million worth of products to Turkey in addition to what is exported. Its untapped potential with Kazakhstan and Kyrgyzstan was relatively lower, with $21.8 million and $3.7 million, respectively.

Kazakhstan also misses a significant export potential with Turkey. It could export $577.6 million worth of products if factors that prevent these potentials' utilization were removed. On the other hand, Kazakhstan almost fully utilized its export potentials with Azerbaijan and Kyrgyzstan in 2019, where there were only $34 million and $48.7 million untapped export potential, respectively. Kyrgyzstan has the lowest magnitude of untapped export potential, mainly due to the smaller size of the economy. However, it could export over $60 million worth of products more than what it actually exports to Kazakhstan, $21.4 million more to Turkey, and $4.6 million more to Azerbaijan.

Turkey falls short of utilizing a significant amount of export potential with other TC-4 countries. In 2019, there was a gap of $569.4 million with Azerbaijan, $755.9 million with Kazakhstan, and $478.6 million with Kyrgyzstan between what is exported and what could be exported to these countries. In total, Turkey experienced more than $1.8 billion of untapped export potential with TC-4.

Analyses on export potentials can be further expanded to sectoral and product level to see the highest export potentials. In 2019, with almost $36 million, wood, paper, rubber, and plastics constituted the largest untapped potential between Azerbaijan and other TC-4, particularly Turkey (Figure 4.1). It was followed by horticulture ($20 million, mainly with Kazakhstan), minerals, metals, and their products ($19.7 million, mostly with Turkey), and processed food and animal feed ($18.5 million, mainly with Turkey).

Figure 4.1: Top Five Sectors with Untapped Export Potentials (2019, million $US)

AZERBAIJAN

	Kazakhstan	Kyrgyzstan	Turkey
Wood, paper, rubber, plastics	1,9	0,4	33,7
Horticulture	14,2	1,4	4,4
Minerals, metals & products thereof	1,6	0,3	17,8
Processed food & animal feed	0,3	0,1	18,0
Vegetal products n.e.s	2,6	0,4	9,4

KAZAKHSTAN

	Azerbaijan	Kyrgyzstan	Turkey
Minerals, metals & products thereof	17,3	15,8	312,0
Vegetal products n.e.s	2,7	2,6	45,6
Animal and animal products	3,0	0,5	24,1
Chemicals	2,6	1,3	23,0
Processed food & animal feed	1,3	0,4	21,4

KYRGYZSTAN

	Azerbaijan	Kazakhstan	Turkey
Minerals, metals & products thereof	4,5	16,6	10,1
Horticulture	0,004	18,7	0,9
Manufactured products n.e.s	0,02	13,3	2,6
Machinery & electronic equipment	0,003	2,8	0,9
Apparel & textile products	0,01	2,8	0,6

TURKEY

	Azerbaijan	Kazakhstan	Kyrgyzstan
Minerals, metals & products thereof	189,1	134,5	35,7
Apparel & textile products	31,5	51,2	263,6
Vehicles	58,3	140,4	36,7
Machinery & electronic equipment	56,7	109,4	19,4
Wood, paper, rubber, plastics	42,7	88,1	15,5

Source: International Trade Centre, Export Potential Map

Kazakhstan's untapped export potential lay mainly in minerals, metals, and their products (Figure 4.1). It could export $345 million more of these products to other TC-4 in 2019, mostly to Turkey. Turkey also remained the leading partner of Kazakhstan with the most considerable untapped export potentials in other sectors. In vegetal products, there was an opportunity to

trade $51 million more, mainly with Turkey. Kazakhstan had a chance to export $27.6 million more of animal and animal products.

As in Kazakhstan, minerals, metals, and their products constituted the most considerable untapped export potential of Kyrgyzstan in 2019, with over $31 million, mainly with Kazakhstan (Figure 4.1). Horticulture ($19.7 million, mostly with Kazakhstan), manufactured products ($15.9 million, mainly with Kazakhstan), and machinery & electronic equipment ($3.7 million, mainly with Turkey) revealed high untapped export potentials for Kyrgyzstan with other TC-4 countries in 2019.

Turkey's leading sector with the highest untapped export potential was minerals, metals, and their products (Figure 4.1). It constitutes $359,3 million additional export potential for Turkey, mainly with Azerbaijan and Kazakhstan. In 2019, apparel and textile products ($346 million, mostly with Kyrgyzstan), vehicles ($235 million, mainly with Kazakhstan), machinery & electronic equipment ($186 million, mostly with Kazakhstan), and wood, paper, rubber, and plastics ($146,3 million, mainly with Kazakhstan) were other sectors with great export potential for Turkey to remaining TC-4 countries.

In addition to sectoral level analysis, Figures 4.2-4.5 show the products with the most export potentials for TC-4 countries. For 2019, the following top three products are found to have the highest export potential in each market:

Azerbaijan:

- *In Kazakhstan:* (i) tomatoes, (2) cane or beet sugar & chemically pure sucrose, (iii) fresh fruit, nes.
- *In Kyrgyzstan:* (i) tomatoes, (ii) apples, (iii) cane or beet sugar & chemically pure sucrose.
- *In Turkey:* (i) polyethylene, specific gravity (<0.94), (ii) aluminium, not alloyed, (iii) polyethylene in primary forms.

Kazakhstan:

- *In Azerbaijan:* (i) wheat (excl. durum) and meslin, (ii) oil/gas casing and tubing, (iii) flat rolled products of iron or non-alloy steel.
- *In Kyrgyzstan:* (i) wheat (excl. durum) and meslin, (ii) waters as beverage, (iii) wheat or meslin flour.
- *In Turkey:* (i) copper cathodes, (ii) aluminium, not alloyed, unwrought (iii) wheat (excl. durum) and meslin.

Kyrgyzstan:

- *In Azerbaijan:* (i) gold, semi-manufactured, (ii) kidney beans, (iii) portland cement.
- *In Kazakhstan:* (i) float glass, nes, (ii) portland cement (iii) bread, pastry.
- *In Turkey:* (i) cotton, not carded/combed, (ii) gold-semi-manufactured, (iii) kidney beans.

Turkey:

- *In Azerbaijan:* (i) motor vehicles for the transport of >=10, (ii) bars and rods of iron or non-alloy steel (iii) sanitary articles.
- *In Kazakhstan:* (i) motor vehicles for the transport of persons, nes, (ii) floor coverings of man-made textiles, made up, (iii) motor vehicles for the transport of >=10.

- *In Kyrgyzstan:* (i) men's trousers & shorts of cotton (ii) t-shirts & vests of cotton, knit/crochet (iii) women's trousers & shorts of cotton.

Figure 4.2: Products of Azerbaijan with most Export Potential (2019)

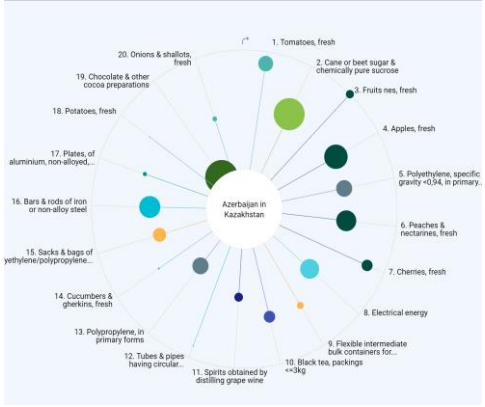
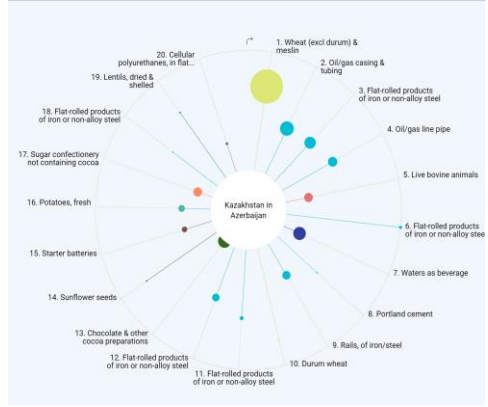
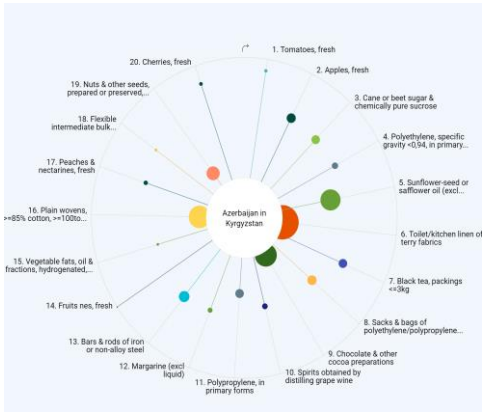
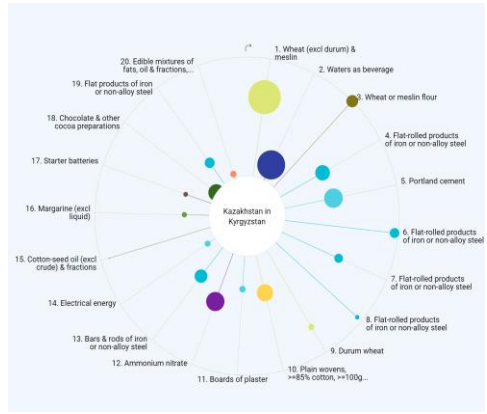
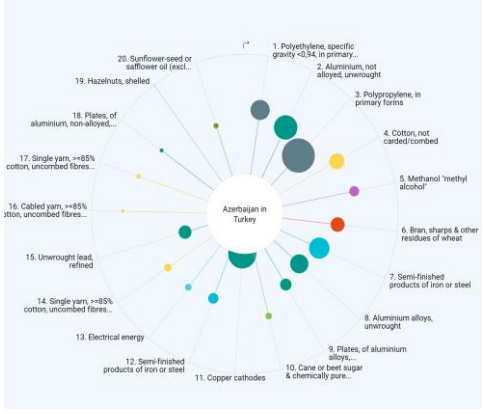


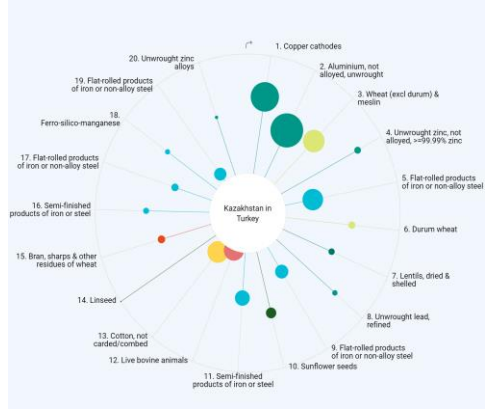
Figure 4.3: Products of Kazakhstan with most Export Potential (2019)











Source: International Trade Centre, Export Potential Map. Data as accessed on 27 December 2020.

Figure 4.4: Products of Kyrgyzstan with most Export Potential (2019)

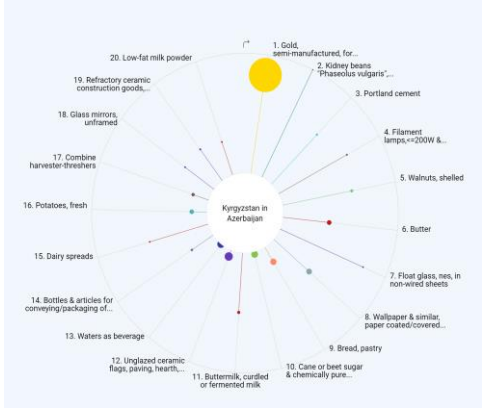
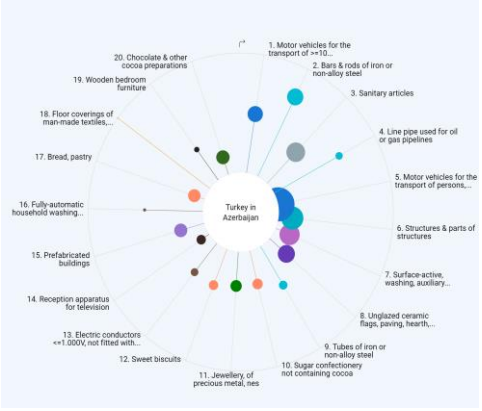
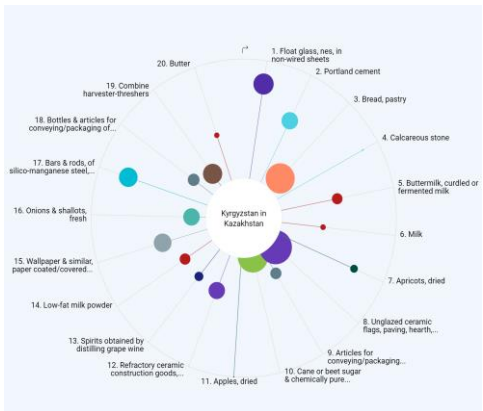
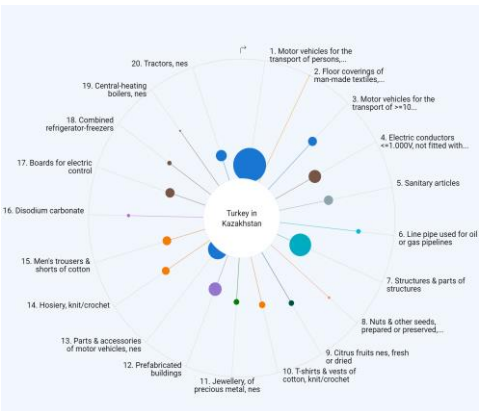
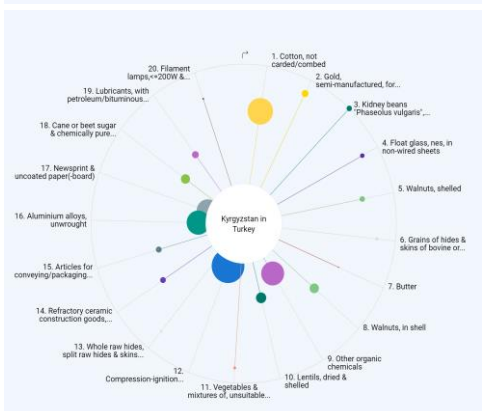


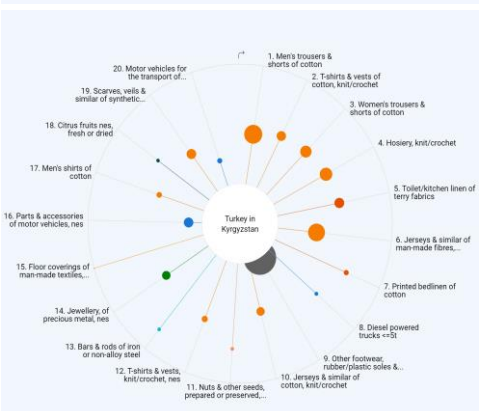
Figure 4.5: Products of Turkey with most Export Potential (2019)











Source: International Trade Centre, Export Potential Map. Data as accessed on 27 December 2020.

Products listed in Figures 4.2-4.5 are the top products with the highest export potential in each market. However, it does not indicate the gap between actual and potential exports. Some countries may be utilizing these potentials, but there are large gaps between actual exports and potential exports in most cases. Therefore, the Turkic Council Member States trade

advisors should further investigate the products and sectors with great export potentials and encourage their exporters to enter other Member States' markets. This may require negotiations with relevant authorities to reduce any barriers that may exist for exporters.

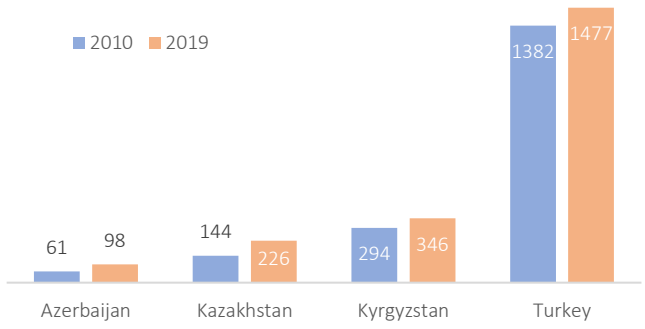
4.2 Comparative Advantages and Trade Complementarities

Assessment of capacities in which products have export potential heavily relies on their comparative advantages. Comparative advantage refers to a country's ability to produce goods and services at a lower opportunity cost than other countries. Having a comparative advantage is not the same as being the best at something. However, it allows a country to sell goods and services at a lower price than its competitors and realize more gains. The theory of comparative advantage provides a strong argument in favor of free trade and specialization among countries.

A standard tool for measuring a country's comparative advantage is the Balassa's revealed comparative advantage (RCA) measure. The RCA compares the share of a product in a country's total exports with its share in world exports. It shows whether the country has a relative advantage (RCA > 1) or disadvantage (RCA < 1) in exporting the goods. Comparative advantage is what makes an economy more competitive than its rivals because of cost advantages.

The RCA values at six-digit international trade classification are calculated to determine the number of products each TC-4 country has a comparative advantage. To compare the performance of countries over time, this calculation is made for 2010 and 2019. As shown in Figure 4.6, Azerbaijan had a comparative advantage in 61 products in 2010, but it increased to 98 in 2019. Kazakhstan had a comparative advantage in 144 products in 2010, and it managed to have a comparative advantage in 226 products in 2019. Similarly, Kyrgyzstan successfully increased the number of products in which it had a comparative advantage from 294 in 2010 to 346 in 2019.

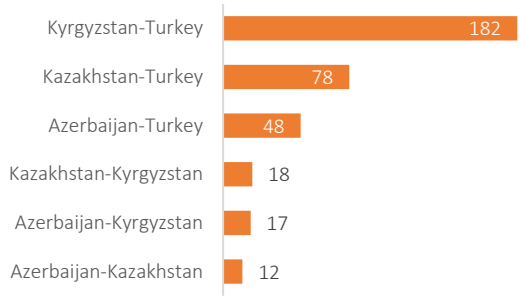
Figure 4.6: Comparative Advantages (Number of Products)



Source: WITS - World Bank based on UN Comtrade.

The highest number of products with comparative advantage was observed in Turkey. It had a comparative advantage in 1382 products in 2010, and it could further increase it to 1477 in 2019. Calculations were made using the data for 4938 products listed under six-digit level reported according to Harmonized System (HS) 2007. In this

Figure 4.7: Similarities in Comparative Advantages (2019, number of products in total exports)



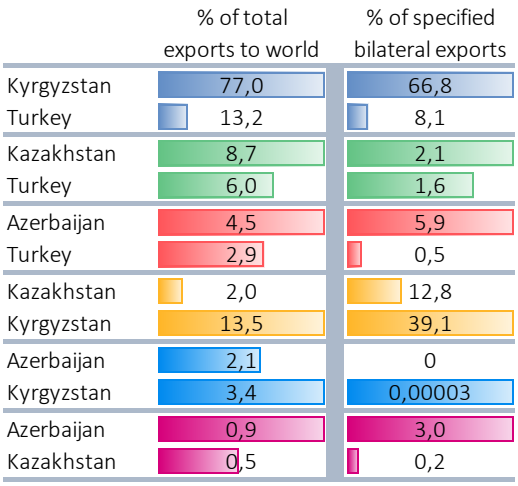
Source: WITS - World Bank based on UN Comtrade.

connection, Turkey's ability to have a comparative advantage in 30% of all products shows the Turkish economy's particular strength in international trade. This also explains Turkey's more tremendous export potential in other markets compared to other countries in the region.

In connection with improving intra-regional trade, an important question would be whether each Member States' comparative advantages overlap. Suppose countries have a comparative advantage in the same products. In that case, the prospects for trade complementarity between the economies will be lower. Figure 4.7 shows the number of products where TC-4 countries have comparative advantage similarities. In 2019, the highest number of products with the same comparative advantages emerged between Kyrgyzstan and Turkey, with 182 products. Kazakhstan and Turkey had similar comparative advantages in 78 products, and Azerbaijan-Turkey in 48 products. A smaller number of similar comparative advantages was between Azerbaijan and Kazakhstan (12 products).

In order to see how intra-regional trade is shaped by comparative advantages that the TC-4 countries have, the shares of bilateral trade in products where economies have a comparative advantage are calculated. Products listed in Figure 4.7 constituted near 6% of intra-TC4 trade in 2019 (according to data reported by first countries in Figure 4.7). However, in bilateral trade relations picture looks something different. 182 products on which Kyrgyzstan and Turkey had common comparative advantages in 2019 constituted 77% of Kyrgyzstan's exports to the world and almost 67% of its exports to Turkey (Figure 4.8). On the other hand, 39% of Kyrgyzstan's exports to Kazakhstan were also realized with products that both countries possess a comparative advantage. Other findings of Figure 4.8 imply that comparative advantages do not significantly constrain trade complementarities among TC-4 countries,

Figure 4.8: Shares of Similarities in Comparative Advantages (2019, percent)



Source: WITS - World Bank based on UN Comtrade.

with exemptions of Kyrgyzstan exports to Turkey and Kazakhstan. The list of products where at least three countries from the TC-4 group had the same comparative advantage in 2019 is provided in Table 4.2. As can be seen, these products were mainly raw or processed agricultural and mineral products. The two products that all TC-4 countries had a comparative advantage were other potatoes fresh or chilled, and cotton not carded or combed.

Table 4.2: List of Products where At Least Three Countries from the TC-4 Group Had the Same Comparative Advantages in 2019

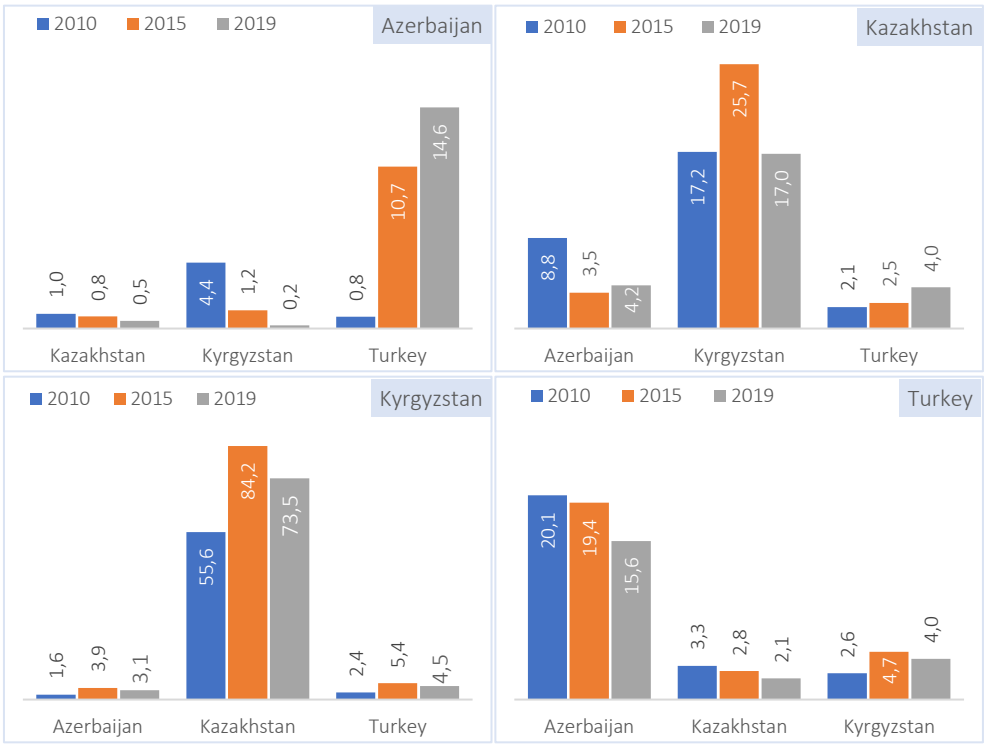
70190	Other potatoes fresh or chilled
70310	Onions and shallots
71320	Chickpeas (garbanzos)
71340	Lentils
80910	Apricots
151229	Cotton-seed oil and its fractions
240220	Cigarettes containing tobacco
230610	Oil-cake and other solid residues of cotton seeds
261690	Precious metal ores and concentrates (excl. silver ores and concentrates)
271119	Petroleum gases and other gaseous hydrocarbons - liquefied
520100	Cotton not carded or combed

Source: WITS - World Bank based on UN Comtrade.

The trade intensity index (TII) uses similar logic to that of revealed comparative advantage, but for markets rather than products. It indicates whether a reporter exports more, as a percentage, to a partner than the world does on average. It is measured as country i's exports to country j relative to its total exports divided by the world's exports to country j relative to the world's total exports. If the TII equals 1, trade partners are trading without geographic bias. Values above (below) 1 indicate that the trade between the two countries is more (less) intensive than expected. Azerbaijan's trade intensity with Kyrgyzstan and Kazakhstan was falling over the years and reached below 1 in 2019, indicating a weaker trade relation compared to the world average. However, its trade relations with Turkey are steadily improving over the years to reach 14.6 in 2019 (Figure 4.9).

For Kazakhstan, remaining TC-4 countries enjoy high trade intensity, indicating Kazakhstan's stronger trade relations with Azerbaijan, Kyrgyzstan, and Turkey. Its strongest relation is with Kyrgyzstan, for which its trade intensity decreased from 25.7 in 2015 to 17 in 2019. This bilateral trade relations become much more potent when it is evaluated from the perspective of Kyrgyzstan. In 2019, Kazakhstan was almost 74 times more important for Kyrgyzstan than average country in the world. Turkey and Azerbaijan also remained a dependable trade partner for Kyrgyzstan in 2019, with TII scores of 4.5 and 3.1, respectively. Turkey also has strong trade relations with the remaining TC-4 countries, particularly with Azerbaijan. However, Turkey's trade intensity with Azerbaijan has decreased from 19.4 in 2015 to 15.6 in 2019 (Figure 4.9)

Figure 4.9: Trade Intensities



Source: WITS - World Bank.

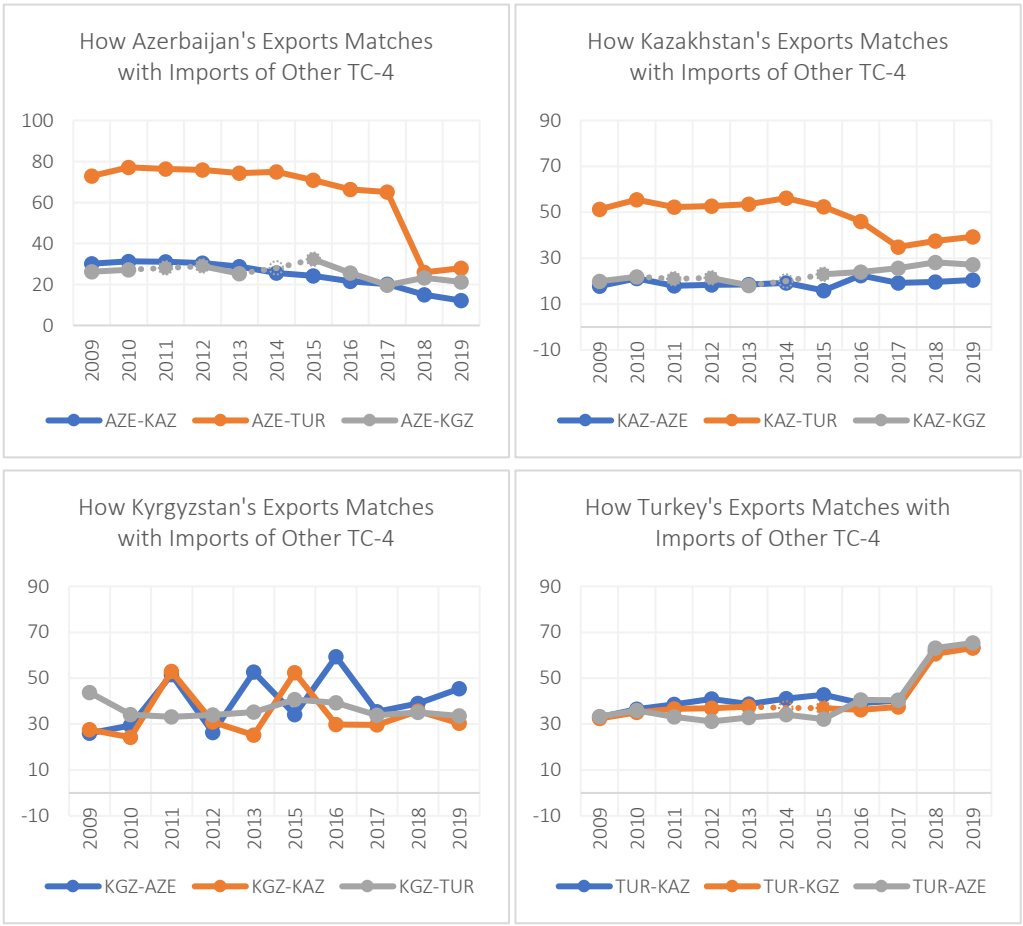
Although analyses on comparative advantages and trade intensities provide some insights on the potential complementarities of bilateral trade, other tools provide more information about complementarities and possible trade. An index developed for this purpose is trade complementarity index (TCI). The TCI indicates the extent to which the reporter's export profile matches, or complements, the partner's import profile. In other words, it measures the extent to which the two countries are "natural trading partners." The index takes zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match. A high index may indicate that the two countries would gain from increased trade and may be particularly useful in evaluating prospective bilateral or regional trade agreements.

Trade complementarity indices can be traced over time. Figure 4.10 shows the evolution of TCIs for TC-4 countries from 2009 to 2019. Azerbaijan has the highest complementarity rate with Turkey, explaining strong trade relations between the two countries. Turkey had a 95% share in Azerbaijan's export to TC-6 in 2019. However, the TCI value is falling over the last few years, indicating decreasing complementarity of trade. Trade of Azerbaijan with Kazakhstan and Kyrgyzstan seems to be less complementary, with TCI scores 12.11 and 21.16 in 2019, respectively. Kazakhstan's export profile has the highest resemblance with Turkey's import

profile, where TCI was calculated at 39.28 in 2019. This also explains the higher share of trade between the two countries. TCI values for Kazakhstan and Azerbaijan are relatively lower and stand at 20.54 in 2019, indicating lower trade complementarity.

There is no particular country with more substantial complementarities with Kyrgyzstan's exports. There are significant fluctuations over time in TCI values for its trade with Azerbaijan and Kazakhstan. However, they remain on average around the same values. As of 2019, complementarity scores between Kyrgyzstan and other TC-4 countries were around 30-45, reflecting moderate complementarity. The 2017-2019 period is witnessing increasing trade complementarities between Turkey and the rest of the TC-4 countries. As of 2019, TCI for Turkey with its TC-4 partners ranged between 63 and 65, which are also the highest observed complementarity scores within the TC-4 group.

Figure 4.10: Trade Complementarities



Source: UN Comtrade database.

4.3 Impacts of Trade Facilitation Measures on Trade Volume

There is great trade potential between the Member States of the Turkic Council if collaboration towards reducing trade barriers and harmonizing policies take place. Moreover, there are alternative forms of economic cooperation and integration. Preferential trade agreements are probably the most basic form of any regional economic integration. Customs Union and Monetary Union are a more advanced arrangement of economic integration.

Member States could start with the most basic economic integration form. When countries form a regional trade agreement, they apply lower tariffs and cooperate on many other policy areas that reduce overall bilateral trade costs among member countries beyond the removal of explicit trade barriers. Therefore, the importance of such an agreement should not be underestimated.

Currently, Azerbaijan, Kazakhstan, and Kyrgyzstan are practicing free trade among themselves. These countries are not applying customs duties, taxes, and levies, which have an equivalent effect and quantitative restrictions to import and/or export goods originating from one of the contracting parties (WTO, 1999). As observed in section 3, tariff rates among these three countries are zero, except for very few products.

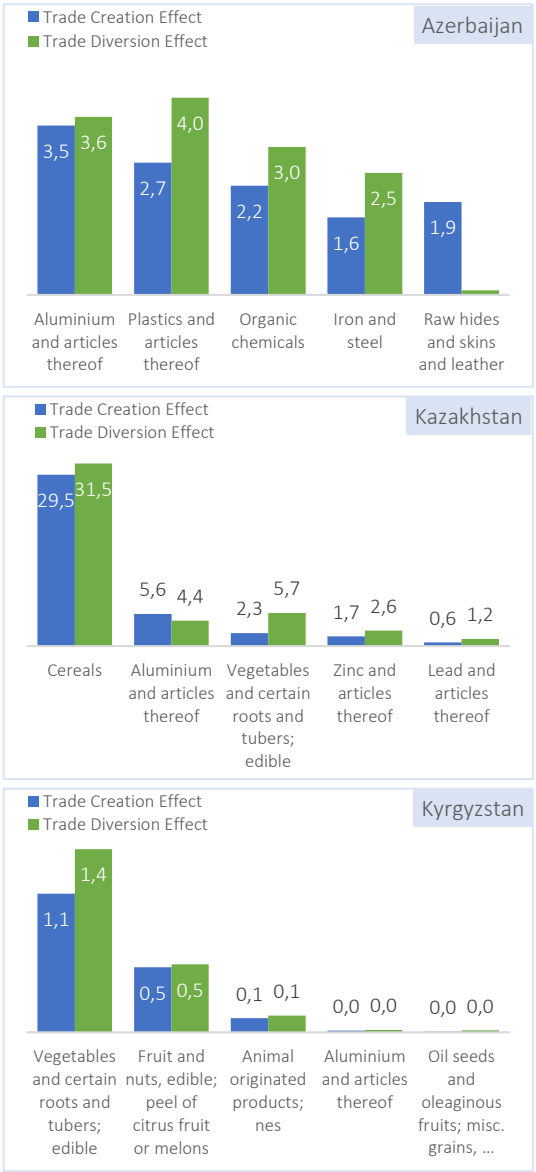
Kazakhstan and Kyrgyzstan are also parties to the Treaty on a Free Trade Area between CIS members, which entered into force in 2012. These two countries are also members of the Eurasian Economic Union (EEU). The EEU aims to ensure free movement of goods, services, capital, and labor within its borders and seek the creation of a common market for goods, services, capital, and labor within the Union. Therefore, economic integration between Kazakhstan and Kyrgyzstan is reasonably advanced compared to the rest of TC-4 countries.

TC-4 countries are also members of the Economic Cooperation Organization (ECO), which also has its trade agreement entered into force in 2008. The agreement aims to reinforce economic cooperation among the ECO Member States by eliminating non-tariff barriers, reducing tariffs, and exchanging concessions. More specifically, the parties agreed to reduce tariffs to a maximum of 15% as the highest tariff slab. It also puts that any Contracting Party shall apply no prohibitions or restrictions other than tariffs by means of quotas, other quantitative restrictions, import licensing, or other restrictive measures on imports from other Contracting Parties.

Most of the trade and investment agreements among Azerbaijan, Kazakhstan, and Kyrgyzstan are shaped by their historical relationships within the CIS region. Turkey typically remains outside of these constellations. All TC-4 countries are also members of other regional organizations, such as the Organization of Islamic Cooperation (OIC) and the Asian Development Bank (ADB). Therefore, the Turkic Council must decide how to promote regional integration among its Member States. The first option would be to create a new free trade area among its members. However, noting that Azerbaijan, Kazakhstan and Kyrgyzstan have almost no tariff barriers, such an option may not be the optimum scenario. Alternatively, one of the existing trade agreements could be extended to cover all Member States. This could be

less burdensome for the parties, but one or more Member States may not be willing to enter into a free trade agreement with a non-Member States as part of such practices.

Figure 4.11: Impact of Free Trade between Turkey and Other TC-4 Countries (Million $US)

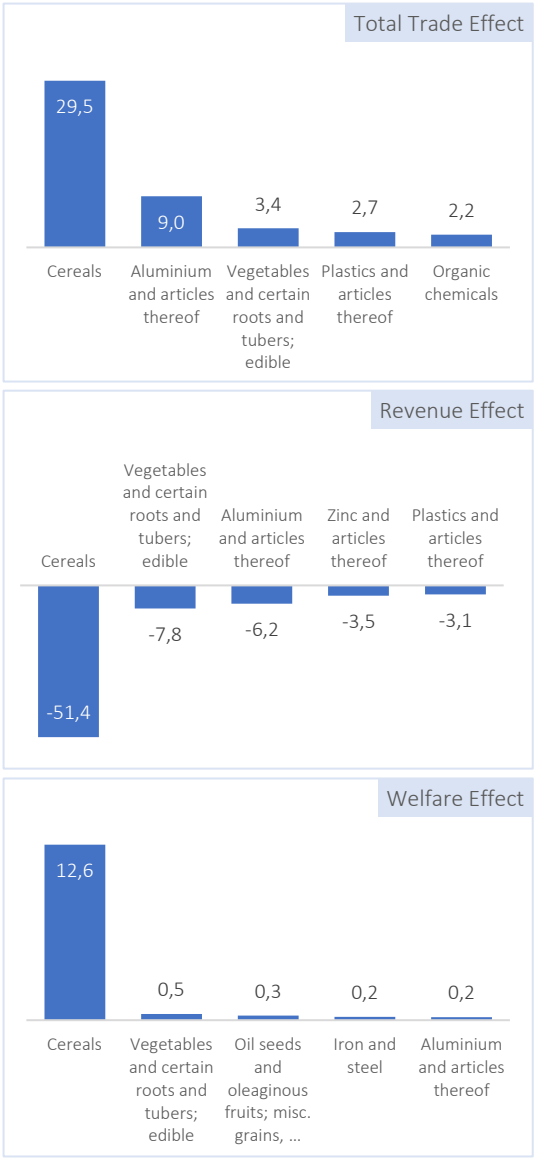


Source: WITS - World Bank, SMART Module.

It may still be desirable to create an FTA within the TC region, with the further ambition to form a customs union to reduce trade barriers further and improve trade relations within the region. To see the potential consequence of an FTA between the TC-4, a simulation analysis is conducted where all tariff rates are reduced to zero. Applied tariff rates are zero for almost all products for trade among Azerbaijan, Kazakhstan, and Kyrgyzstan. However, trade between Turkey and other TC-4 face major trade barriers. Therefore, the simulation exercise covers only the trade between Turkey and other TC-4 countries.

Figure 4.11 shows the trade creation and trade diversion effect for Azerbaijan, Kazakhstan, and Kyrgyzstan if Turkey reduces tariffs to zero for all products. Such a scenario would produce significant trade within the TC-4 region. It would create more than $13 million export for Azerbaijan and more than $14 million additional export diverted from other countries. In total, Azerbaijan would export more than $27 million to Turkey, mainly aluminum products, plastic products, and organic chemicals. The highest trade effect would be observed for Kazakhstan. Zero tariffs with Turkey would bring more than $41 million in new exports. An additional $46 million worth of exports would be diverted from other countries. The most critical impact would be observed in the exports of cereals that would be a source of an additional $61 million export to Turkey. Although a small economy, Kyrgyzstan could also benefit from the elimination of tariffs. It could export around $4 million more to Turkey due to such concessions, particularly in vegetables and fruits.

Figure 4.12: Total Impact of Free Trade between Turkey and Other TC-4 Countries (by sectors, million $US)



Source: WITS - World Bank, SMART Module.

To sum up, there would be around $55 million in Turkey's additional imports (a trade creation effect) if tariffs would be eliminated. Most of this new trade would be generated in cereals and aluminum products (Figure 4.12). However, there are significant tariff revenues gained by countries. Elimination of tariffs would also indicate the loss of these revenues. Figure 4.12 shows that it would cause more than $51 million in revenue loss due to cereal imports and almost $30 million loss due to imports of other products. These losses are due to additional trade created with tariff reductions and abandoning of revenue collection from already imported goods.

However, loss of revenues does not imply a welfare loss for Turkey. Since consumers will obtain the imported products at a lower price, they will be positively affected by reduced tariff rates. Overall welfare impact will be positive for Turkey, occurring mainly from cereals import, reaching over $13 million (Figure 4.12).

In addition to eliminating tariffs by Turkey, other TC-4 could also eliminate tariffs for imports from Turkey. This would also create essential gains for Turkish importers and consumers in the other Member States. It would be an opportunity for Turkey to export almost $300 million more to other TC-4, but mostly to Azerbaijan, which would account for $180 million additional import from Turkey (Figure 4.13). $114 million exports would be newly created, while $66 million would be diverted from other markets.

The diversion could take place not only from non-Member States but also from the other TC-4 countries. Elimination of tariffs for Turkish exporters in Azerbaijan would encourage them to export to Azerbaijan instead of Kazakhstan, Kyrgyzstan, or other countries.

Figure 4.13: Total Trade Effect of Free Trade between Other TC-4 and Turkey (Million $US)

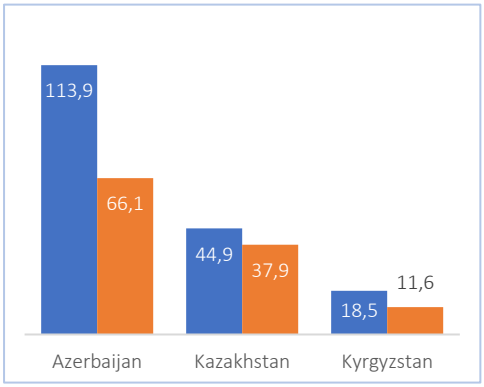
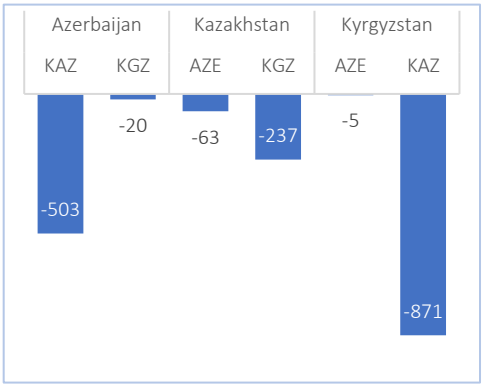


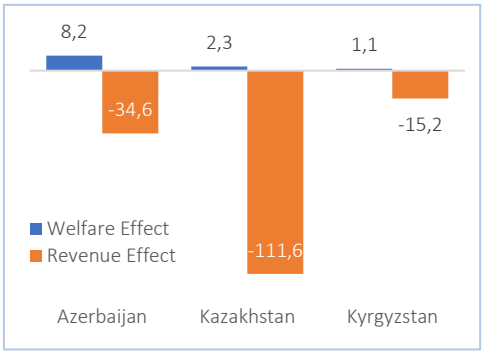
Figure 4.14: Trade Diversion Effect of Free Trade between Other TC-4 and Turkey (Thousand $US)



Source: WITS - World Bank, SMART Module.

As shown in Figure 4.14, the trade diversion effect is not entirely negligible. Elimination of Azerbaijan tariffs for Turkish exporters would divert more than $0.5 million from Kazakhstan to Azerbaijan and $20 thousand from Kyrgyzstan. Elimination of Kazakhstan tariffs would shift $63 thousand from Azerbaijan and $237 thousand from Kyrgyzstan to Kazakhstan. Finally, Kyrgyzstan's elimination of tariffs would cause trade diversion from Azerbaijan around $5 thousand and $871 thousand from Kazakhstan, which is the most considerable trade diversion effect.

Figure 4.15: Welfare and Revenue Impact of Free Trade between Other TC-4 and Turkey (Million $US)



Source: WITS - World Bank, SMART Module.

As in Turkey's case of tariff elimination, there are also welfare and revenue impacts for other TC-4 if they eliminate tariffs for Turkey. The welfare effect is highest in Azerbaijan ($8.2 million), followed by Kazakhstan and Kyrgyzstan (Figure 4.15). The revenue effect is most extensive in Kazakhstan with $111.6 million, followed by Azerbaijan ($34.6 million) and Kyrgyzstan ($15.2 million).

CHAPTER

Current Trends in Investment

5 Current Trends in Investment

After a short introduction on the importance of investment for growth and development, this chapter discusses the current trends in investment in Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey (TC-4) by looking at foreign direct investment (FDI) flows and stock datasets, bilateral FDI datasets as well as sectoral FDI datasets. In this way, the chapter aims to reveal the current state of investment in TC-4 and identify investment trends within the region. The chapter also looks into sectoral FDI datasets to reveal the level of concentration of multinational companies in TC-4 that would help understand factors that lead them to invest more into those sectors. This analysis would also help shape the policy responses on attracting more investors, particularly to strategic sectors, that would generate higher economic growth and contribute more to TC-4's development as a group.

5.1 Importance of Investment for Growth and Development

Where the investment is low, the productive capacity of the economy struggles to grow. This results in lower rates of growth and job creation and fewer opportunities for the poor to break away from the poverty cycle. Investment tends to promote growth and productivity. Investment in infrastructure is significant for the development of developing economies and least developed countries (LDCs). LDCs generally suffer from insufficient, inappropriate, and poorly maintained infrastructure (UNCTAD, 2018).

One type of investment in the focus of considerable attention is FDI. According to the International Monetary Fund (IMF), foreign direct investment refers to an investment made to acquire a lasting interest in enterprises operating outside of the investor's economy. Further, in FDI cases, the investor´s purpose is to gain an influential voice in the enterprise's management. Several studies found out that there is a positive correlation between FDI and economic growth (SESRIC, 2015). In some countries, the positive impacts of FDI may stay limited due to crowding out of local investments, low quality of FDI, and problems associated with the host economy's absorptive capacity.

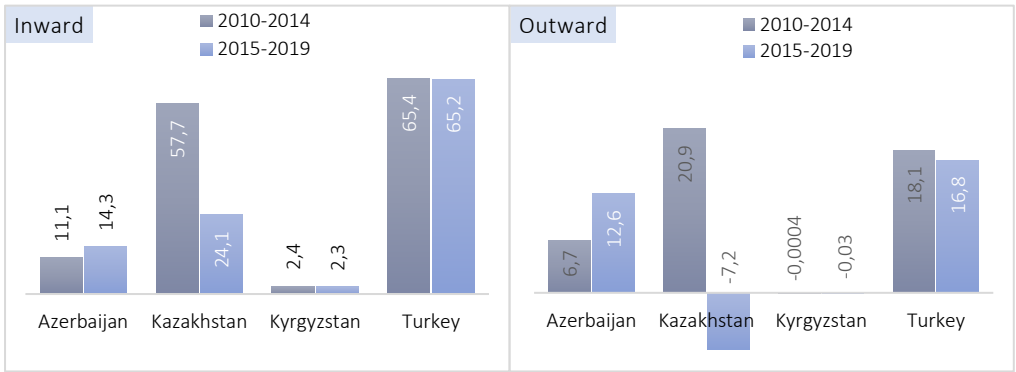
In some cases, FDI crowds out local investment because local firms cannot compete with foreign firms due to size, financing, and marketing power limitations. Besides, foreign investors' expatriation of profits may lead to the stagnant growth in the host country, and transfers demand to the international market rather than the domestic market (Reis, 2002). The quality of FDI is crucial for inducing growth in the economy. Alfaro and Charlton (2007) emphasize the critical role of the sectoral composition of FDI inflows on the potential spillover advantages derived from FDI, as those advantages differ markedly across primary, manufacturing, and services sectors. For example, FDI in the extractive sector may have

limited beneficial spillovers for growth as it often involves mega projects that rarely employ domestically-produced intermediate goods or labor (Lim, 2001). The policy implication for TC-4 is that the policies are needed to direct FDI inflows to the productive sectors of the economy, and the emphasis should be on both the quality and quantity of FDI. Finally, host economies need to possess the necessary absorptive capacities in terms of institutional quality to benefit from expected positive impacts such as economic development and financial development (Hermes and Antras, 2003; Lensink, 2004; Makki and Somwaru, 2004).

5.2 State of Investment in TC-4 Countries

As the size of TC-4 economies varies, there is a limited similarity in terms of the volume of FDI directed to them. Nevertheless, given their size of the population, geography, and economic potentials, FDI inflows to TC-4 generally remained sub-potential (Figure 5.1). The total value of FDI inflows to TC-4 went down from $136.6 billion in 2010-2014 to $105.9 billion in 2015-2019. A similar picture was seen in FDI outward flows that went down from $45.7 billion in 2010-2014 to $22.2 billion in 2015-2019. Turkey attracted the highest amount of FDI inward flows in the 2015-2019 period ($65.2 billion), followed by Kazakhstan ($24.1 billion) and Azerbaijan ($14.3 billion). However, only Azerbaijan among TC-4 countries managed to increase inward and outward FDI flows in two periods compared (2010-2014 and 2015-2019). In the same compared periods, inward and outward FDI flows to Kazakhstan have significantly decreased and slightly decreased in Turkey's case. Kyrgyzstan experienced only a modest level of FDI inflows. In 2010-2019, FDI inflows to Kyrgyzstan averaged near $469 million per year.

Figure 5.1: FDI Inward and Outward Flows (Billion US$)

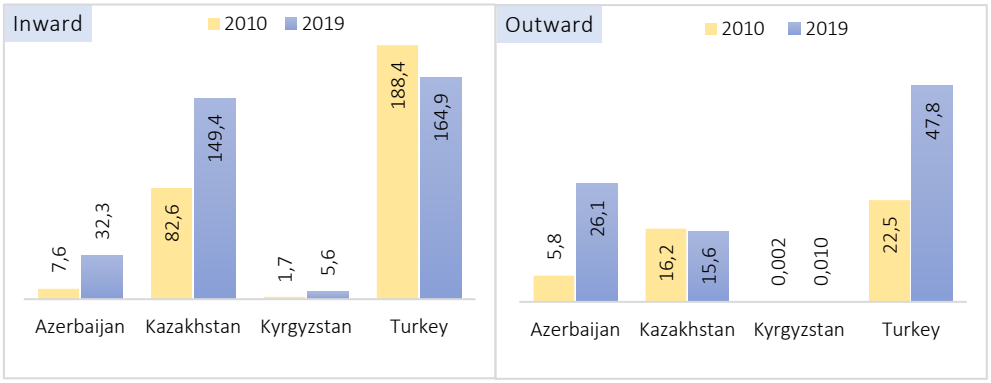


Source: UNCTAD database.

Figure 5.2 presents the FDI stock figures of TC-4 for the years 2010 and 2019. Turkey accumulated the highest outward FDI stocks level ($47.8 billion) in 2019 among TC-4. It was followed by Azerbaijan ($26.1 billion). Turkey hosted near $165 billion FDI inward stock in 2019 and was followed by Kazakhstan ($149,4 billion) in the same year.

In 2019, TC-4 economies altogether attracted 0.9% of the total world FDI inflows and hosted 1% of the world FDI inward stocks. In 2010, the share of TC-4 in the world's FDI inward stocks was 1.4%. Therefore, it can be claimed that over the last ten years, the performance of TC-4 economies as a group in attracting FDIs went down.

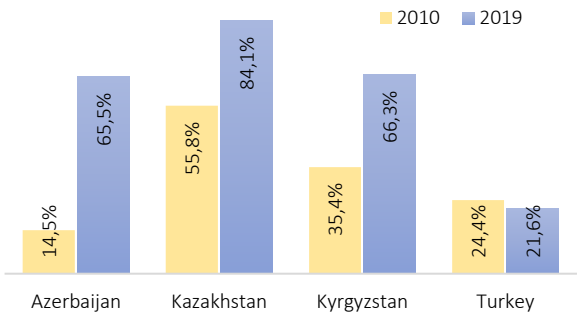
Figure 5.2: FDI Inward and Outward Stock (Billion US$)



Source: UNCTAD database.

Another way of looking into countries' investment performance is to assess FDI figures as a percentage of gross domestic product (GDP) and gross fixed capital formation (GFCF). These percentages are significant in understanding the overall importance of FDI in the national economies and assessing the investment environment. In this regard, Figure 5.3 reveals that the relative importance of FDI inward stocks in GDP increased in Azerbaijan, Kazakhstan, and Kyrgyzstan over the period 2010-2019. In 2019, this indicator's value was 65.5% in Azerbaijan, 84.1% in Kazakhstan, and 66.3% in Kyrgyzstan. In the same year, FDI inward stock as a percentage of GDP was lowest in Turkey (21.6%), which could stem from the relatively larger size of GDP compared to the rest of TC-4 economies.

Figure 5.3: Inward FDI Stock as Percentage of GDP

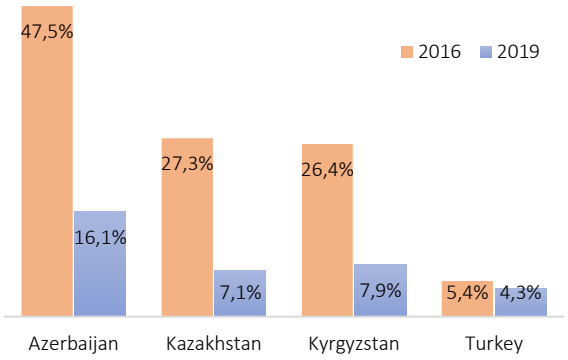


Source: UNCTAD database

According to Figure 5.4, FDI inflows made a relatively smaller contribution to the GFCF in 2019 compared to 2016 in all TC-4 economies. The most striking fall was recorded in Azerbaijan from 47.5% in 2016 to 16.1% in 2019. Kazakhstan and Kyrgyzstan also witnessed a remarkable reduction in this value in the same period. In particular, the high volatility in such figures may affect national economic growth trajectories and can change perceptions towards foreign investors. In this regard, policies need to be

developed to ensure that FDI makes a smooth, sustainable, and foreseeable contribution to TC-4' gross fixed capital formation.

Figure 5.4: FDI Inflows as Percentage of Gross Fixed Capital Formation

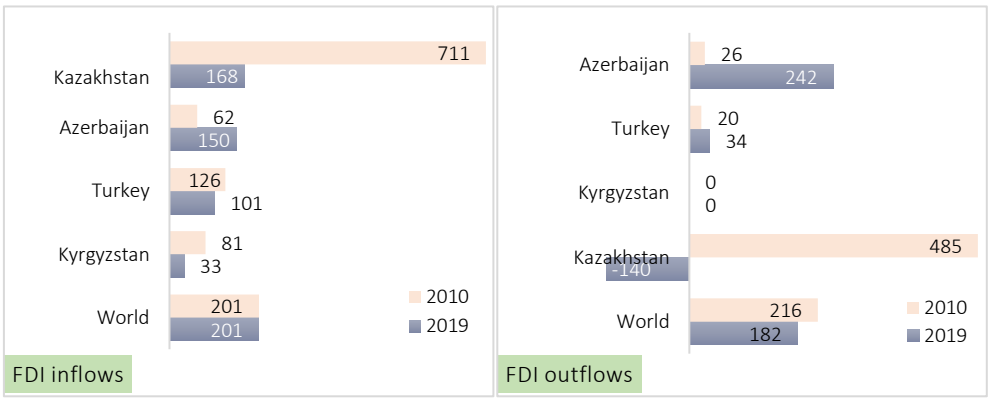


Source: UNCTAD and Word Bank database.

A very high level of FDI inward stocks as a percentage of GDP comes with some particular risks, especially in developing countries. For instance, foreign investors may want to relocate their investments to another country in any economic and political shock. In that case, such a relocation decision may harshly hit the host country's economy when backward and forward linkages of foreign investors are counted. In this regard, while economic policies should focus on attracting more FDI in TC-4 economies, domestic investment and entrepreneurial environment should be strengthened to reduce such potential risks.

An additional way of assessing the relative importance of FDI in a country is to measure FDI in per capita terms to scale down the volume of FDI with the population's size. In this way, it is relatively easier to make cross-country comparisons. According to Figure 5.5, TC-4 countries attracted FDI inflows below the world average of $201 per capita in 2019. Compared with 2010, per capita FDI inflows are reduced in TC-4 countries in 2019, except for Azerbaijan.

Figure 5.5 Per Capita FDI Flows (Current $US)



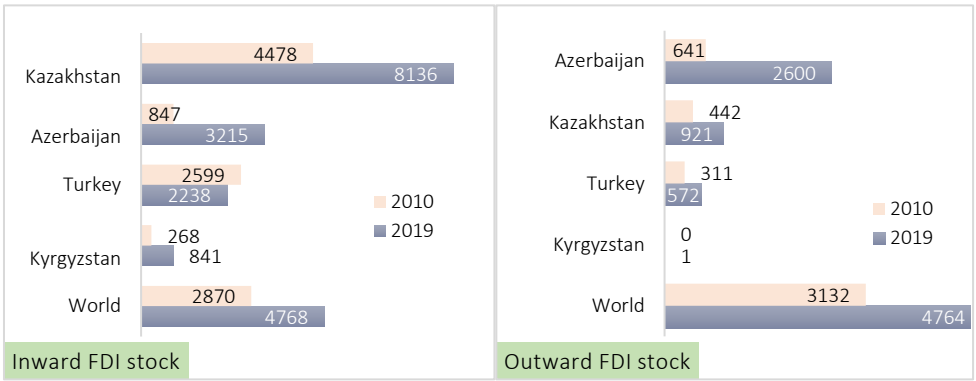
Source: UNCTAD database.

In terms of per capita FDI outflows, compared to the two years (2010 and 2019) the performance of TC-4 except Azerbaijan ($242 per capita) was worse than the level of per capita FDI inflows. Turkey ($34 per capita) invested abroad less than the world average in 2019.

Kyrgyzstan did not invest at all, while Kazakhstan experienced disinvestment in assets. Disinvestments can appear, for example, when the direct investor sells its interest in a direct investment enterprise to a third party or back to the direct investment enterprise.

In a similar vein, Figure 5.6 depicts TC-4 economies' performance in terms of per capita FDI inward and outward stocks. TC-4 countries except Turkey recorded progress in per capita inward stock over the period from 2010 to 2019. As of 2019, Kazakhstan ($8,136) and Azerbaijan ($3,215) hosted the highest FDI inward stock in per capita terms among TC-4. Kazakhstan even exceeded the average of the world ($4,768) in 2019. Azerbaijan ($3215), Turkey ($2,238), and Kyrgyzstan ($841) stayed below the world average in the same year. It is essential to mention that over the period from 2010 to 2019, Azerbaijan increased its per capita FDI inward stocks 3.8 times. In this period, Kyrgyzstan also made a commendable effort by increasing the same figure by 3.1 times. In terms of per capita FDI outward stocks, Azerbaijan was the number one among TC-4 countries with a value of $2600 in 2019 and followed by Kazakhstan ($921), Turkey ($572), and Kyrgyzstan ($1) in the same year. These figures reveal that when FDI flows and stocks are measured in per capita terms, TC-4 countries' performance does not resemble a high similarity level.

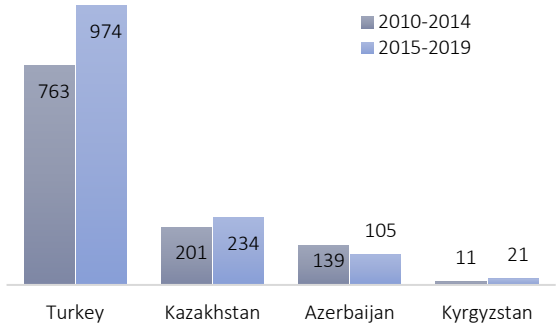
Figure 5.6: Per capita FDI Stock (Current $US)



Source: UNCTAD database.

The volume of FDI flows and stock is a useful measure to understand foreign investors' level of interest in a particular economy. Nevertheless, looking at greenfield investment figures may provide additional insights as they are usually recognized as a more beneficial entry form of investment in which the parent firm constructs its own subsidiary company in a foreign country. It implies expanding the existing capital stock in an economy and increasing productivity thanks to technology transfer (European Commission, 2017; Harms and Meon, 2014). In this regard, Figure 5.7 and 5.8 report the number and value of greenfield FDI projects in TC-4 countries. According to Figure 5.7, the total number of announced greenfield FDI projects was the highest in Turkey over 2010-2019. In total, 1737 projects were reported by Turkey, and Kazakhstan followed it with 435 recorded projects in this period.

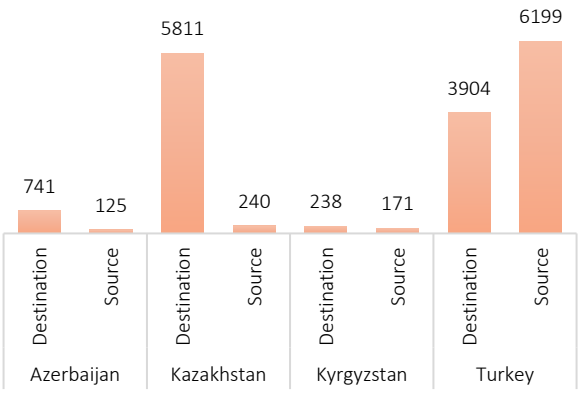
Figure 5.7: Number of Announced Greenfield FDI Projects



Source: UNCTAD, World Investment Report 2020, Annex Table 17.

A closer look into the value of the announced greenfield investment project in 2019 would give a better idea of whether TC-4 economies emerge as a destination or source country for greenfield investors. According to Figure 5.8, in 2019, Azerbaijan, Kazakhstan, and Kyrgyzstan attacked more greenfield investors as destinations than greenfield investment projects that they carried out in other countries. Only Turkey was a net investor in terms of the announced greenfield investment project's value in 2019. The value of the announced greenfield investment project originated from Turkey amounted to $6199 million in 2019. One of the effective ways to attract and retain greenfield FDI projects is to have Special Economic Zones (SEZ) in which host countries provide an attractive investment infrastructure with certain advantages (e.g., tax incentives, low transport, and energy costs) for investors (UNCTAD, 2019). In general, SEZ can enable a more favorable climate for new investments (both local and foreign) in a shorter time. Moreover, they allow for delivering high-quality utility services at favorable rates, including vocational training, logistics, and appropriate tax regimes. SEZ also provides one-stop-shop services that are issuing licenses and permits much more effectively compared to municipalities.

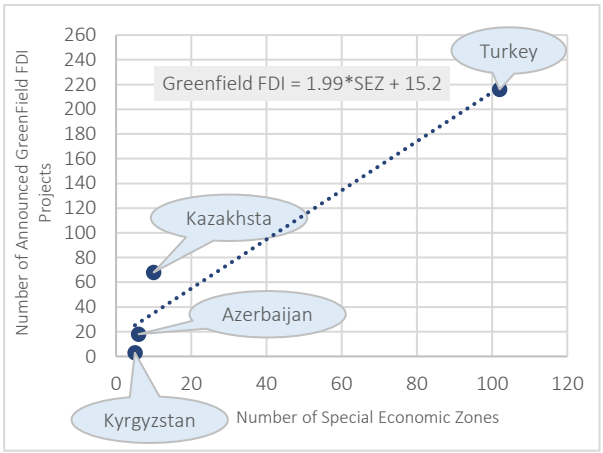
Figure 5.8: Value of Announced Greenfield Investment Project in 2019 (Millions $US)



Source: UNCTAD, World Investment Report 2020, Annex Tables 13 and 14.

TC-4 countries with more SEZ tend to report more greenfield FDI projects in 2018. For instance, Turkey, with 102 SEZ, announced 216 greenfield FDI projects in 2018. Figure 5.9 reveals that all else equal, each additional SEZ associates with about two new greenfield FDI projects in TC-4 on average. In this respect, one way of maximizing the number of greenfield FDI projects in the Member States is to develop new SEZ and rehabilitate the existing ones for providing a more compelling investment infrastructure, especially for new investors.

Figure 5.9: Number of Special Economic Zones versus Number of Greenfield FDI Projects (2018)



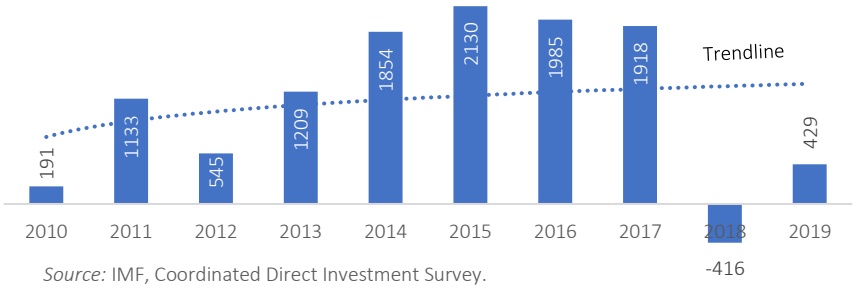
Source: UNCTAD, World Investment Report 2019.

Overall, the analysis reveals that independent of how FDI figures are measured, it is almost impossible to conclude that TC-4 countries reached their potentials to host and attract foreign investors. TC-4 economies still need to exert more efforts to reach their economic growth potentials, address investment gaps, and create more jobs by attracting and retaining FDI with an ultimate goal of achieving sustainable development.

5.3 Investment among Turkic Council Member States

Intra-regional investments are among the vital indicators to assess the level of economic integration among TC-4 economies. Intra-regional FDI figures reflect directed investment from one Turkic Council country to another. A higher volume of intra-regional FDIs implies the existence of more robust economic ties among them. According to Member States' official data reported to the IMF's Coordinated Direct Investment Survey, inward FDI flows among TC-4 countries increased almost fourfold from $545 million in 2012 to $2,130 million in 2015. Turkey and Azerbaijan showed the largest gains in regional FDI inflows over this period. However, Figure 5.10 points out to deceleration in intra-TC-4 investment in the period after 2015. Still, the overall trendline for the period from 2010 to 2019 remains to be positive.

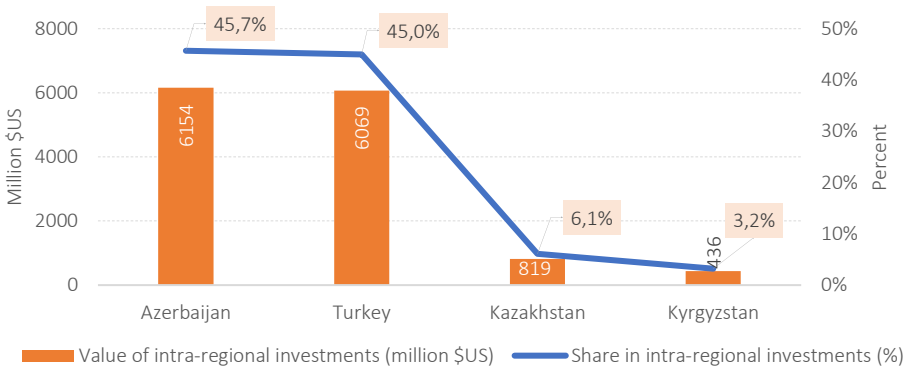
Figure 5.10: Investments Among TC-4 Countries (Inward FDI flows, million)



Source: IMF, Coordinated Direct Investment Survey.

In 2019, the total stock of intra-TC-4 FDI inflows amounted to near $13.5 billion. Azerbaijan led intra-regional FDI stock inflows by nearly $6.2 billion, followed by Turkey with over $6 billion. 91% of intra-regional inward FDI stock belongs to Turkey and Azerbaijan. The stock of intra-regional investment attracted by Kazakhstan amounted to $819 million in 2019. Kyrgyzstan's same value was $436 million, according to the IMF data (Figure 5.10).

Figure 5.11: Investments Among TC-4 Countries (2019, inward FDI stock)



Source: IMF, Coordinated Direct Investment Survey.

Table-5.1 presents the breakdown of regional (intra-TC-4) FDI stock inflows at the bilateral level. In 2019, 98.5% (near $6.1 billion) of regional inward FDI stock in Azerbaijan had originated from Turkey. Similarly, with 92.9% (or $761 million), Turkey dominated Kazakhstan's regional inward FDI stock. Turkey appears as the second significant regional investor (after Kazakhstan) for Kyrgyzstan. The share of Kazakhstan in regional FDI inward stock represents 54.7% ($239 million) in Kyrgyzstan, 2% ($102 million) in Turkey, and 1.5% ($92 million) in Azerbaijan. While most of Kazakhstan's regional FDIs have concentrated in Kyrgyzstan, FDI originating from Azerbaijan represented a share of 98% (near $6 billion) in Turkey's regional FDI inward stock (Table 5.1).

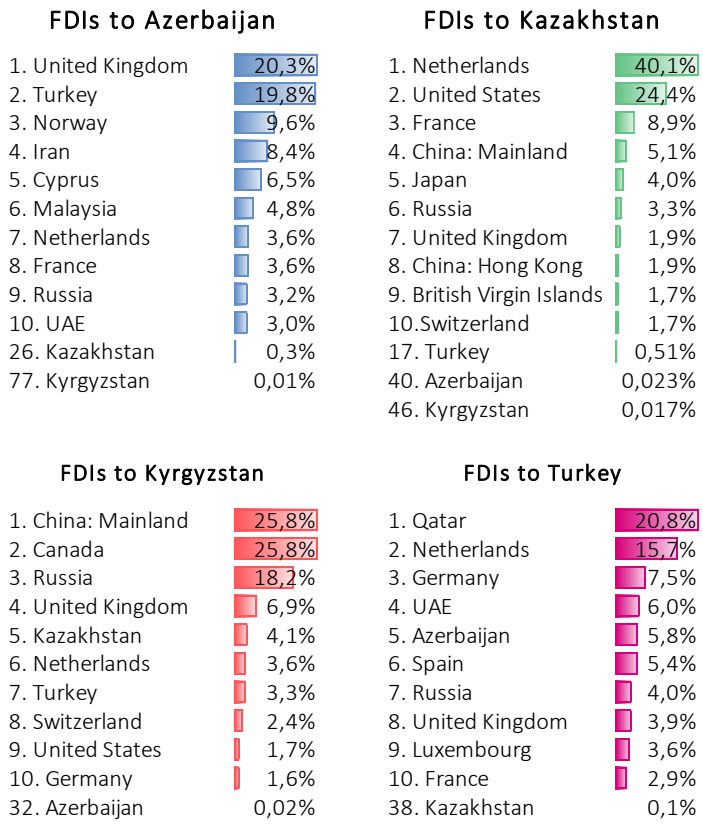
Table 5.1: Bilateral Shares in Regional Inward FDI stock (2019, values in millions in brackets)

Investors \ Recipients	Azerbaijan	Kazakhstan	Kyrgyzstan	Turkey
Azerbaijan	N/A	4.1% (34)	0.3% (1)	98% (5967)
Kazakhstan	1.5% (92)	N/A	54.7% (239)	2% (102)
Kyrgyzstan	0.05% (3)	3% (25)	N/A	0
Turkey	98.5% (6059)	92.9% (761)	45% (196)	N/A

Source: IMF, Coordinated Direct Investment Survey.
Note: Data as reported by countries. N/A: Not applicable.

Top-10 investors in TC-4 economies as of the end of 2019 are listed in Figure 5.12. Turkey appeared as the second biggest investor in Azerbaijan (19.8% of total inward FDI stock) and the seventh-largest investor in Kyrgyzstan (3.3%). Azerbaijan held fifth place (5.8%) in Turkey's inward FDI stock, whereas Kazakhstan was the fifth largest investor (4.1%) in Kyrgyzstan. In the rest of the cases, TC-4 countries do not appear as significant investors among themselves.

Figure 5.12: Top-10 Investors in TC-4 Countries
(Percent of inward FDI stock, 2019)

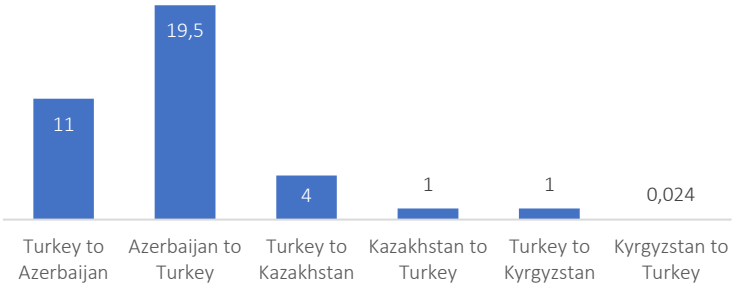


Source: IMF, Coordinated Direct Investment Survey.

The reader should be careful while evaluating bilateral or intra-regional investments. Official statistics of investor countries are recording only the capital that is directly exported from the national economy. Investments realized through third countries are not reflected in national statistics. For example, the FDI of one Turkish company investing through Norway to Azerbaijan is not reflected in Turkey's outward FDI statistics. On the other hand, the FDI of the same Turkish company is being registered as an investment of Norway in Azerbaijan's inward FDI statistics. For that reason, the amount of intra-regional inward FDI stock of Member and Observer States could be much higher than officially declared statistics. For example, according to the information available on the official webpage of the Ministry of Foreign Affairs

of Turkey, in 2019, the stock of Turkish FDIs in Azerbaijan was $11 billion. The stock of Azerbaijan's FDIs in Turkey reached $19,5 billion in the same year. Again, the Ministry of

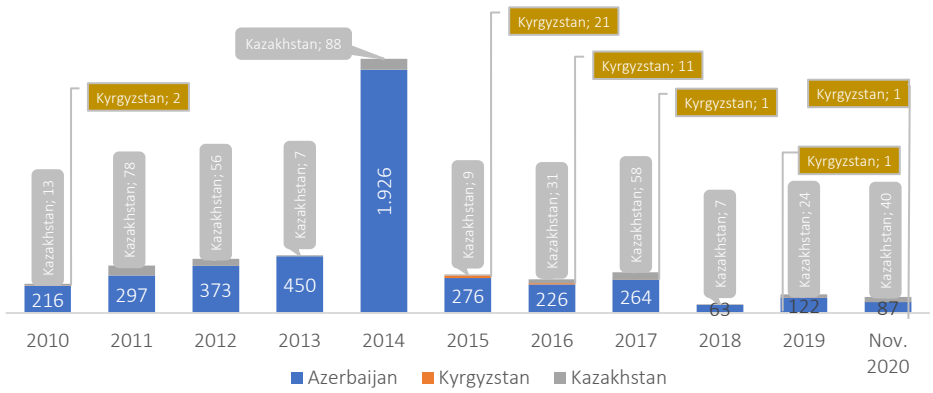
Figure 5.13: Alternative Estimates on Bilateral Investments (2019, inward FDI stock, billion)



Source: Azerbaycan'ın Ekonomisi, http://www.mfa.gov.tr/azerbaycan-ekonomisi.tr.mfa; Kırgızistan'ın Ekonomisi, http://www.mfa.gov.tr/kirgizistan-cumhuriyeti-ekonomik-iliskileri.tr.mfa; Ayşe Böcüoğlu Bodur, Kazakistan'dan Türkiye'ye 'Yatırımlarınızda Üs Olabiliriz' Mesajı, *Anadolu Ajansı*, 4 Kasım 2019.

Foreign Affairs of Turkey estimates $1 billion of total Turkish investments in Kyrgyzstan and $24 million of Kyrgyzstan's FDI stock in Turkey. Moreover, estimation provided by Kazakhstan Embassy in Ankara indicates to near $4 billion of Turkish FDI stock in Kazakhstan in 2019 and nearly $1 billion of Kazakh FDI stock in Turkey (see Figure 5.13). According to these estimates, in 2019, the total stock of FDI inflows among Turkey and the rest of the TC-4 countries amounted to over $36.5 billion, which is 2.7 times higher than the IMF's data.

Figure 5.14: Turkish Regional FDIs (Outward FDI flows, million)

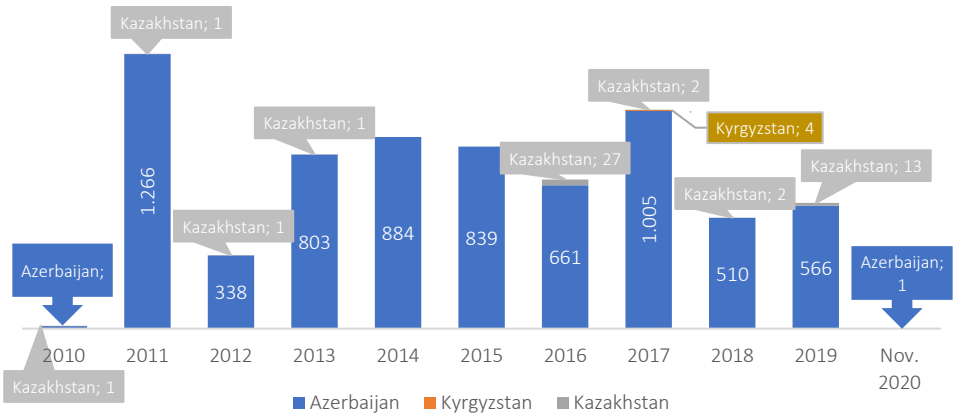


Source: Central Bank of the Republic of Turkey, EVDS Data Central.

There are also differences among official FDI statistics provided by the countries. In general, countries tend to overestimate outward FDIs and give a more approximate picture of inward FDIs. Still, official statistics of Member States provide some additional insights into regional

investments among TC-4 countries. As illustrated in Figure 5.14 and 5.15, the Central Bank of Turkey data shows that Turkey's regional FDIs with the rest of the TC-4 countries are heavily happening with Azerbaijan. From 2010 to November 2020, Turkey invested $4.3 billion in Azerbaijan, $411 million in Kazakhstan, and 37 million in Kyrgyzstan. On the other hand, in the same period, Turkey received near $6,9 billion of FDIs from Azerbaijan, $48 million from Kazakhstan, and $4 million from Kyrgyzstan. In general, due to the Covid-19 pandemic, 2020 was a lost year for Turkey's investment relations with the rest of the TC-4 countries.

Figure 5.15: Regional FDI Inflows to Turkey (Inward FDI flows, million)

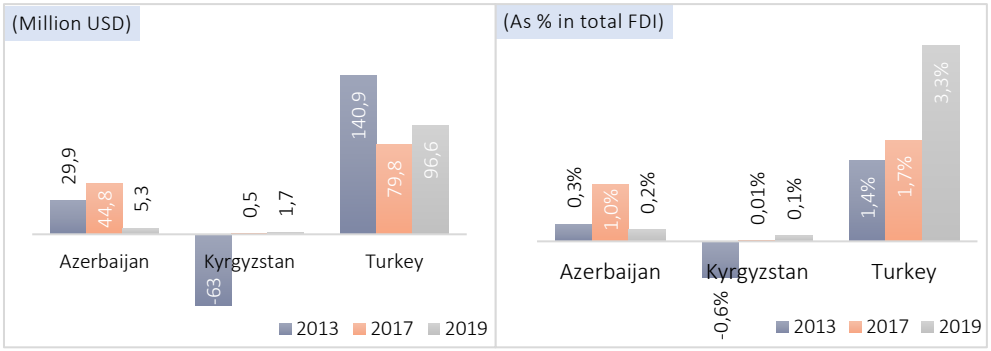


Source: Central Bank of the Republic of Turkey, EVDS Data Central.

According to data obtained from the National Bank of Kazakhstan (Figure 5.16), net FDI inflows in Kazakhstan from Azerbaijan, Kyrgyzstan, and Turkey has followed a volatile trend from 2013 to 2019. Net investment originating from Azerbaijan was $29.9 million in 2013, $44.8 in 2017, and $5.3 million in 2019. Investment from Kyrgyzstan was negative in 2013 ($63 million). Nevertheless, both 2017 and 2019 values were recorded as positive. Turkish net investment in Kazakhstan was also positive in three observed years and was measured at $96.6 million in 2019. Turkey's share grew gradually and represented 3.3% in 2019 in total net FDI inflows of Kazakhstan.

According to bilateral and regional datasets on TC-4 countries, the level of economic integration in FDI reveals the significant untapped potential that needs to be addressed by designing and implementing effective policies at the national and regional levels. TC-4 countries attract low FDI flows given their economic possibilities and does not usually seem to emerge as main investor countries in each other. Nevertheless, this picture could change if the level of economic cooperation at the regional level is elevated. The policy options to unleash the potential investment among TC-4 would have to include the establishment of common investment areas and special economic and investment zones, elimination of investment and trade barriers, design of joint arbitration mechanism to address investment disputes, and development of a regional investment treaty at the level of Member States.

Figure 5.16: Net FDI Inflows in Kazakhstan



Source: National Bank of Kazakhstan.

Moreover, different FDI datasets do not set a clear picture of FDI flows among Turkic Council countries. For that reason, Turkic Council could request commercial consultancies in Member and Observer States' embassies to assist in capturing a more realistic picture of intra-regional investments by using the same methodology and surveying national companies preset in the host countries.

5.4 Investment Patterns at Sectoral Level

All TC-4 countries have made steps to create a more favorable investment climate and continue their efforts in doing so. Turkic Council Member States recognizes FDI as essential inputs for the diversification of economies, financing investments, and expanding economic activities. Looking into the distribution of FDIs in various subsectors of TC-4 countries may help identify the sectors with higher potential and competitiveness to attract foreign investors both from the Member States and beyond.

Azerbaijan

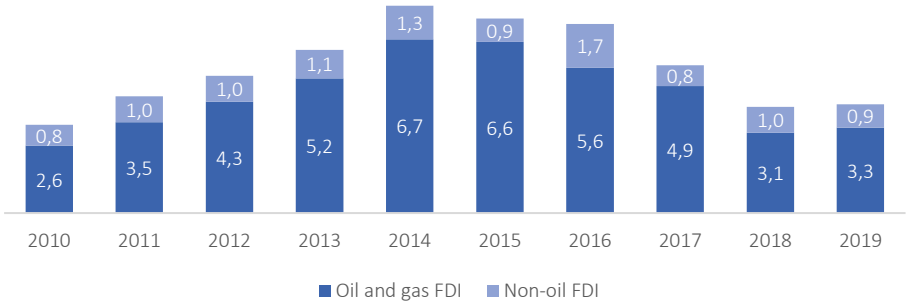
The government of Azerbaijan is implementing a program of reforms designed to create a more inviting environment for investment, and progress has been evident in some areas. Foreign investments enjoy complete and unreserved legal protection under the Law on the Protection of Foreign Investment, the Law on Investment Activity, and guarantees within international agreements and treaties. Currently, Azerbaijan offers a more hospitable climate for oil and gas investors than many oil-producing countries in the MENA region.

Azerbaijan is among the top 10 most energy-dependent economies in the world. Despite the strong growth rates in the non-oil sectors in recent years, these sectors remain constrained by the negative spillover from the oil and gas's dominant position. For that reason, Azerbaijan intends to attract foreign investments in non-oil sectors, particularly those identified as priority areas in the Strategic Roadmap of the National Economy, such as ICT, tourism,

transportation, agriculture, food industry, renewables, light industry and e-government, to diversify its economy and boost economic growth and employment. However, foreign investments in these areas have been limited, and investments in oil-related activities remain dominant.

Figure 5.17 shows that the oil and gas sector is responsible for the great bulk of FDI entering Azerbaijan for many years. From 2010 to 2019, the share of non-oil FDIs averaged 23% in Azerbaijan's inward FDI flows. According to the Central Bank of the Republic of Azerbaijan, non-oil FDIs have risen steadily until 2014 and became notably volatile in the 2015-2019 period.

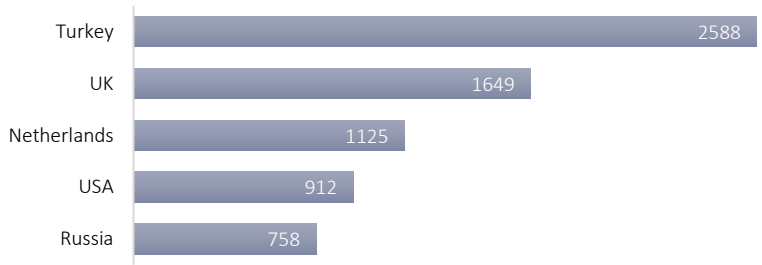
Figure 5.17: FDI Inflows in Azerbaijan (Billion $US)



Source: Central Bank of the Republic of Azerbaijan.

According to the State Tax Service Office under the Ministry of Economy of the Republic of Azerbaijan, as of March 2020, the number of foreign affiliates[1] registered in Azerbaijan reached 15,059. Among them, 9,953 were active, 4,307 were suspended, and 799 were liquidated. Active foreign affiliates were mostly operating in the service sector, trade, industry, and other fields.

Figure 5.18: Countries of Origin of Foreign Investors in Azerbaijan in Non-Oil Sector (2000-2017, top five, million $US)



Source: Azer Mehtiyev, "Foreign Direct Investment in Azerbaijan's Economy: Current Status, Development Trends and Challenges," *Baku Research Institute*, 23 October 2018.

[1] A foreign affiliate is an enterprise resident in one country which is under the control of an institutional unit resident in another country.

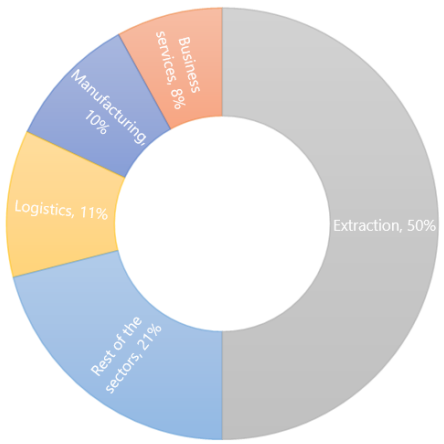
Figure 5.18 presents the top five investor countries according to foreign investors' origin in Azerbaijan's non-oil sector over 2000-2017. Turkey was the leading investor country in the non-oil sector in Azerbaijan that invested about $2,588 million in total and followed by the UK with $1,649 million. The Netherlands, the USA, and Russia were the three remaining top investor countries in Azerbaijan's non-oil sector. As of July 2019, there were more than 3,000 companies with Turkish capital operating in Azerbaijan.

Turkey provides a transit route for the supply of Azeri oil and natural gas to Europe, which also contributes to Turkey's ambition to establish itself as an energy hub in the region. Currently, two major pipelines, the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the Baku-Tbilisi-Erzurum (BTE) gas pipeline carry Azeri hydrocarbons from the Caspian Sea to Turkey. In December 2019, Turkey and Azerbaijan marked the completion of the Trans-Anatolian Natural Gas Pipeline (TANAP). The extension of TANAP, the Trans-Adriatic Pipeline (TAP), began delivering the first gas from Azerbaijan to Italy on 30 December 2020. TAP is expected to deliver 10 billion cubic meters (bcm) of gas a year from Azerbaijan via Turkey, Greece, and Albania to Italy and onwards to other European customers.

Box 5.1: Investment Opportunity in Azerbaijan

Over the period January 2003-September 2017, almost half of greenfield cross-border investment projects in Azerbaijan were realized in the extraction, followed by logistics with a share of 11%. The percentage of FDIs in manufacturing was 10% and in business services 8%. Figure 5.19 reveals that in Azerbaijan, the oil industry is still strong. However, other sectors have become attractive for foreign investors, like logistics and manufacturing. As a result, it is expected that more foreign investors would choose to invest in the non-oil industry in upcoming years. Such potential investment opportunities could be filled by Turkic Council countries if appropriately planned and promoted.

Figure 5.19: Sectoral Distribution of New Greenfield Projects in Azerbaijan (2003-2017)

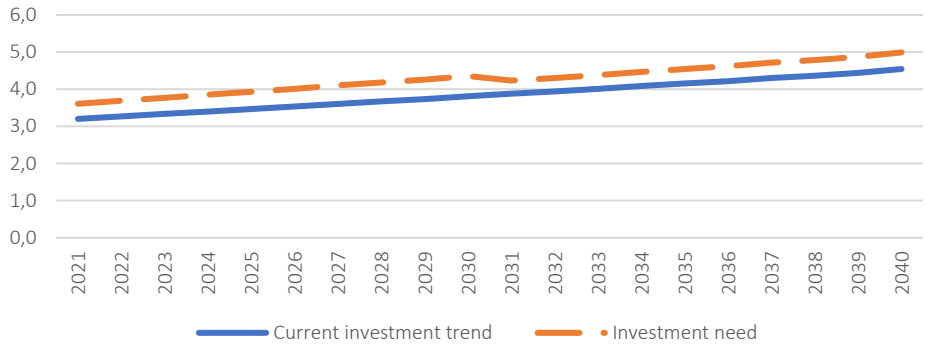


Source: fDi Markets.

According to projections of Global Infrastructure Hub and Oxford Economics, from 2021 to 2040, Azerbaijan will face some shortages in financing infrastructure investments (Figure 5.20). Estimates based on the current investment trend show that by 2040 Azerbaijan will invest $77 billion in transportation, telecommunication, energy, and water infrastructure. However, projected cumulative infrastructure needs by 2040 are $83.9 billion. A total

investment gap of $6.9 billion is expected to originate from investment needs in energy ($4.5 billion), telecommunications ($1.3 billion), airports ($0.6 billion), and water ($0.5 billion) (Table 5.2). Azerbaijan could consider promoting FDI in these infrastructure sectors, particularly encourage Turkic Council Member States in this direction.

Figure 5.20: Projection of Total Infrastructure Investments in Azerbaijan (Billion US$)



Source: Global Infrastructure Hub, Infrastructure Outlook, https://outlook.gihub.org.

Table 5.2: Cumulative Infrastructure Investments in Azerbaijan (2021-2040, billion US$)

	Road	Rail	Airports	Ports	Telecoms	Energy	Water	Total
2021-2040 (Current investment trends - CIT)	36,0	0,7	3,9	4,3	5,5	16,0	10,6	77,0
2021-2040 (Investment need - IN)	36,0	0,7	4,5	4,3	6,8	20,6	11,0	83,9
2021-2040 (Gap between IN and CT)	0	0	0,6	0	1,3	4,5	0,5	6,9

Source: Global Infrastructure Hub, Infrastructure Outlook, https://outlook.gihub.org.

Kazakhstan

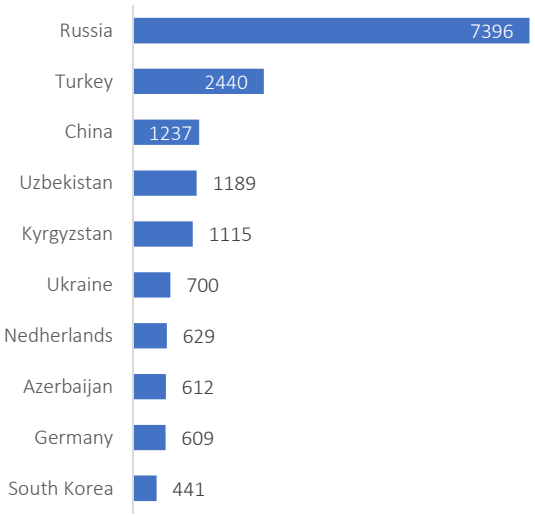
Kazakhstan has adopted the investment-led development strategy, suitable for continued progress toward creating a more favorable climate for foreign investment as part of a long-term plan to elevate Kazakhstan into the world's 30 largest economies. International financial institutions consider Kazakhstan to be an attractive destination for their operations. In August 2017, Kazakhstan's government adopted a new 2018-2022 National Investment Strategy, which outlined new coordinating measures on investment climate improvements, privatization plans, and economic diversification policies. The strategy aims to increase annual FDI inflows as a percentage of GDP from 13.2% in 2018 to 19% in 2022. In April 2019, Kazakhstan announced the creation of the Coordination Council for Attracting Foreign Investment, which is coordinated by the Prime Minister.

Moreover, in 2019, Kazakhstan's government established Direct Investment Fund, located at the Astana International Financial Center (AIFC). It is expected from the Fund to attract

investments for diversifying Kazakhstan's economy. The state company KazakhInvest is also located in the AIFC and offers investors a single-window for government services.

By August 2020, there were near 21,728 companies with foreign participation in Kazakhstan. 97.3% were small companies, 1.5% (325 companies) were medium-sized, and 1.2% (260 companies) were large. Most often, foreign affiliates operate in wholesale and retail trade (8,600). In the construction sector, their number amounted to 2,200; in professional, scientific, and technical activities to 1,600. The largest number of foreign affiliates in Kazakhstan are Russian. 7,396 companies with Russian capital operate in Kazakhstan (Figure 5.21). 3,610 of them are active in the field of trade. Companies with Turkish capital represents the second largest group. 2440 Turkish companies are registered in Kazakhstan, mainly active in the trade, construction, and manufacturing sectors. 172 Turkish companies operate in the sphere of accommodation and catering services. As of August 2020, with 1237 companies, China also entered the top three in terms of the largest number of foreign affiliates in Kazakhstan. 1,189 companies from Uzbekistan, 1,115 companies from Kyrgyzstan, and 612 companies from Azerbaijan were also registered in Kazakhstan in the same period. The total number of registered foreign affiliates in Kazakhstan originating from Turkic Council Member States was 5,356.

Figure 5.21: Top 10 Countries with Number of Foreign Affiliates in Kazakhstan, as of August 2020



Source: Agency for Strategic Planning and Reforms of the Republic of Kazakhstan, Bureau of National statistics.

FDI inflows in Kazakhstan are concentrated in the extractive industries and attracting foreign investment outside these areas, particularly in the manufacturing sector, continues to present a challenge. 51% or $21.7 billion of FDI inflows to Kazakhstan was dedicated to professional, scientific, and technical activities[2] from 2013-2019 and was closely followed by mining and quarrying (41%, or $17.3 billion). In the same period, 8% ($3.3 billion) of FDI inflows went to the construction sector, and only 1% ($292 million) to manufacturing (Table 5.3).

[2] The professional, scientific, and technical activities sector comprises establishments that specialize in performing professional, scientific, and technical activities for others. Activities in this sector include legal advice, accounting; architectural, engineering and specialized design services; computer services; consulting services; research services, advertising services, and other services.

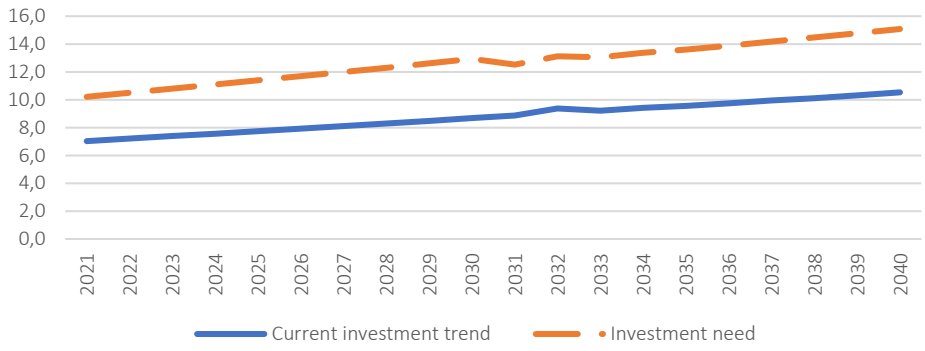
When it comes to Kazakhstan's outward FDI flows, the database of the National Bank of Kazakhstan shows that Kazakhstan's foreign investments are more concentrated in mining and quarrying and transportation and storage activities.

Table 5.3: Sectoral Distribution of Net Inflow of Direct Investment in Kazakhstan (2013-2019)

	Value (Million $US)	Share (%)
Professional, scientific and technical activities	21725	51%
Mining and quarrying	17250	41%
Construction	3293	8%
Wholesale and retail trade; repair of motor vehicles and motorcycles	2488	6%
Financial and insurance activities	958	2%
Real estate activities	355	1%
Manufacturing	292	1%
Administrative and support service activities	215	1%
Agriculture, forestry and fishing	171	0,4%
Accommodation and food service activities	81	0,2%
Other service activities	52	0,1%
Education; human health and social work activities; arts, entertainment and recreation	33	0,1%
Water supply; sewerage, waste management and remediation activities	10	0,02%
Information and communication	-24	-0,1%
Electricity, gas, steam and air conditioning supply	-840	-2%
Transportation and storage	-3478	-8%
Total	**42580**	

Source: National Bank of Kazakhstan.
Note: According to the directional principle. "-" sign implies investment outflow.

Figure 5.22: Projection of Total Infrastructure Investments in Kazakhstan (Billion US$)



Source: Global Infrastructure Hub, Infrastructure Outlook, https://outlook.gihub.org.

Projection done by Global Infrastructure Hub shows that from 2021 to 2040, Kazakhstan may face a $72 billion gap in financing infrastructure investments (Figure 5.22). Estimates based on the existing investment trend indicate that by 2040 Kazakhstan will invest $175.5 billion in

transportation, telecommunication, electricity, and water infrastructure. However, projected cumulative infrastructure needs by 2040 are $247.4 billion. This cumulative investment financing gap is projected to originate from investment needs in roads ($68 billion) and telecommunication ($4 billion) (Table 5.4).

Table 5.4: Cumulative Infrastructure Investments in Kazakhstan (2021-2040, billion US$)

	Road	Rail	Airports	Ports	Telecoms	Electricity	Water	Total
2021-2040 (Current investment trends - CIT)	21,6	30,0	3,2	6,5	28,5	63,6	22,1	175,5
2021-2040 (Investment need - IN)	89,6	30,0	3,2	6,5	32,4	63,6	22,1	247,4
2021-2040 (Gap between IN and CT)	68	0	0	0	4	0	0	72

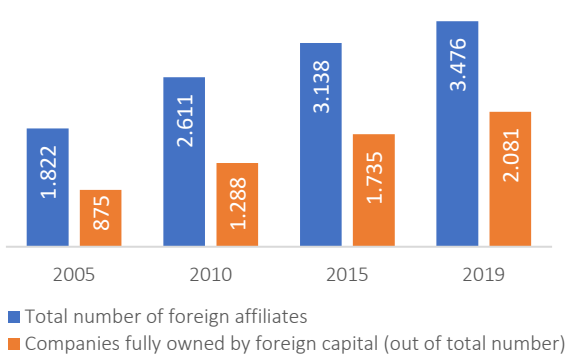
Source: Global Infrastructure Hub, Infrastructure Outlook, https://outlook.gihub.org.

Kyrgyzstan

Kyrgyzstan has identified FDIs as a critical component to improve infrastructure, boost economic growth, and fund the transition to sustainable economic development in the coming years. To attract more FDIs, the government is making efforts to make the investment climate more attractive to foreign investors. Kyrgyzstan already has a clear and incentive-driven FDI legal framework in place. The Investment Promotion and Protection Agency (IPPA) is the designated state body of the Kyrgyz government responsible for coordinating policy aimed at attracting foreign investors to Kyrgyzstan. Apart from IPPA, there are investment councils under the Presidential Administration and Parliament's aegis that also serve to assist foreign investors.

In general, Kyrgyzstan is viewed as a low-cost destination by foreign investors. FDIs are welcomed in every sector of the Kyrgyzstan economy without restrictions. As of January 2021, foreign companies are only banned from future large mining projects. Kazakhstan's policy oriented towards attracting FDIs and improving the general investment climate is occasionally discouraged due to the small market, infrastructure deficits, and political volatility.

Figure 5.23: Number of Active Companies with Foreign Capital

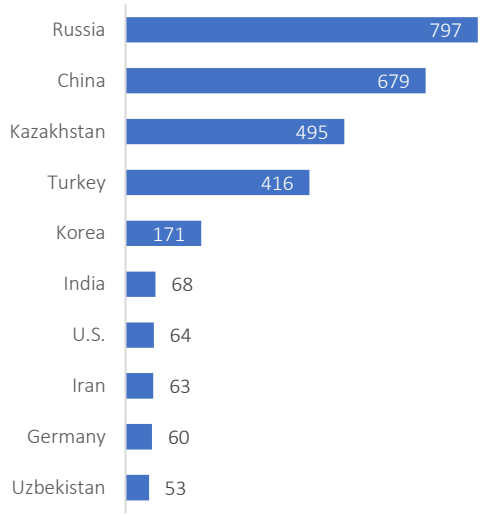


Source: National Statistical Committee of the Kyrgyz Republic.

The number of active companies with foreign capital in Kyrgyzstan has increased from 1,822 in 2005 to 3,467, indicating the growing interest in the Kyrgyz market. In 2019, 60% of these companies were wholly owned by foreign capital (Figure 5.23).

As shown in Figure 5.24, most of the companies with foreign capital registered in Kyrgyzstan belong to Russia (797) and China (679). Kyrgyzstan enjoys very close economic ties with Russia, where many citizens of Kyrgyzstan work. On the other hand, China's economic interests in Kyrgyzstan have been expanding considerably in recent years in all key sectors, including mining. Chinese influence in the Kyrgyz economy is likely to grow with the Uzbekistan-Kyrgyzstan-China railroad construction, which has been agreed in principle. In general, China's business interest is expected to have a stabilizing economic influence on Kyrgyzstan.

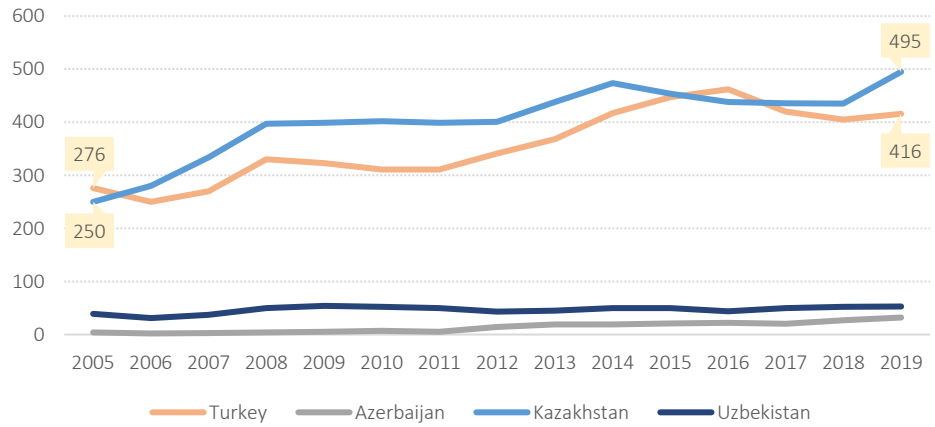
Figure 5.24: Top 10 Countries with Number of Foreign Affiliates in Kyrgyzstan (2019)



Source: National Statistical Committee of the Kyrgyz Republic.

From Turkic Council Member States, 495 foreign affiliates in Kyrgyzstan originate from Kazakhstan, 416 from Turkey, 53 from Uzbekistan, and 32 from Azerbaijan. Figure 5.25 shows that business people's interest from Turkey and Kazakhstan in the Kyrgyz market has grown over the year. After 2011 presence of companies from Azerbaijan has also slightly increased in Kyrgyzstan. The number of companies from Kazakhstan has been doubled in Kyrgyzstan from 2005 to 2019. Kyrgyzstan's membership in Eurasian Economic Union has

Figure 5.25: Evolution of Number of Foreign Affiliates Originating from Turkic Council Member States in Kyrgyzstan



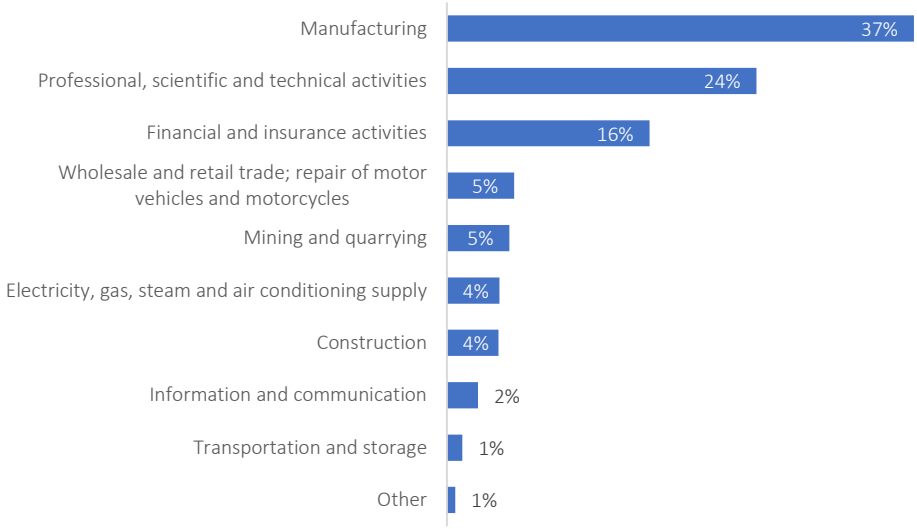
Source: National Statistical Committee of the Kyrgyz Republic.

probably increased Kazakhstan's business people's interest in Kyrgyzstan. Kazakhstan's stronger economy has increasingly led Kyrgyz labor migrants to seek work there, with an estimated 113,000 Kyrgyzstan citizens working in Kazakhstan.

From 2008 to 2019, Kyrgyzstan's leading sectors in attracting FDIs have been manufacturing (37%), the professional, scientific, and technical activities (24%), with financial and insurance activities also attracting attention (%16). The mining and quarrying share in FDI inflows was around 5% during 2008-2019. FDI flows into ICT and transportation sectors remained almost negligible, as is shown in Figure 5.26. Moreover, Kyrgyzstan's agriculture sector, which is added under the "other" category, appears not to be attractive from foreign investors' viewpoint.

According to the National Statistical Committee of Kyrgyzstan, in the period from 2008 to 2019, Kyrgyz companies' outward FDIs have mostly realized in manufacturing (33%) and professional, scientific and technical activities (28%).

Figure 5.26: Entrance of FDIs to Kyrgyzstan by Type of Activity (2008-2019, percent)



Source: National Statistical Committee of the Kyrgyz Republic (NACE, rev.3)

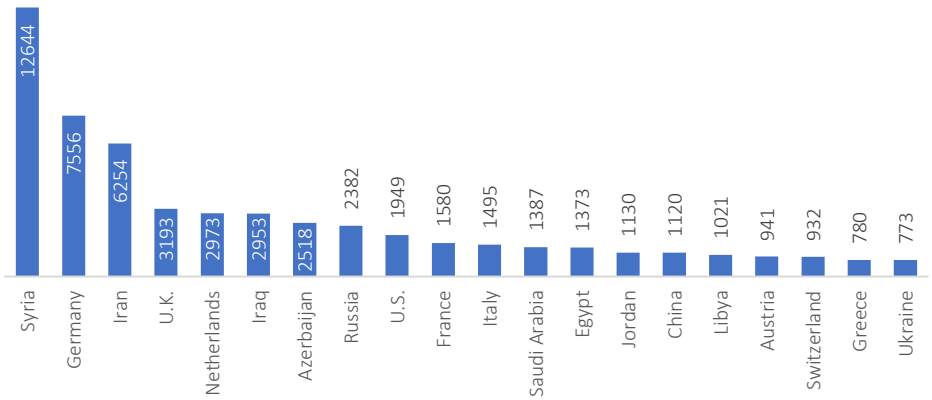
Turkey

Turkey has one of the most liberal legal regimes for FDI in the Organization for Economic Cooperation and Development (OECD). Turkey's regulatory environment is business-friendly. The conditions for setting up a business for foreign companies are the same as those applied to local investors. There are no sector-specific restrictions that discriminate against market access. Foreign ownership or control is allowed for all sectors of the economy. Protection of

investors is strong at World Trade Organization standards, and laws on foreign investment are mainly transparent. The new Turkish Commercial Code that came into force on 1 July 2012 has brought Turkey's business environment into line with that of the EU. Investment Office under the Presidency of the Republic of Turkey is the official organization for promoting Turkey's investment opportunities to the global business community and assisting investors before, during, and after they enter Turkey.

Turkey's economic growth performance and structural reforms implemented over the past two decades have landed Turkey on many international investors' radar. As of October 2020, the number of companies with foreign capital in Turkey reached 72,293. It is interesting to note that among the top 20 countries with the number of foreign affiliates in Turkey, Syria was the first. In January 2021 official number of registered Syrian refugees in Turkey was 3,585,017 persons. 98.4% of them were living in cities and have established above 12600 companies. Out of this exceptional situation, foreign affiliates with capital from EU countries dominate Turkey's market (Figure 5.27). Nevertheless, from 2002 to October 2020, 67% of Turkey's inward FDI flows have originated from the EU countries, according to the Central Bank of the Republic of Turkey's data.

Figure 5.27: Top 20 Countries with Number of Foreign Affiliates in Turkey (October 2020)



Source: Ministry of Industry and Technology of the Republic of Turkey.

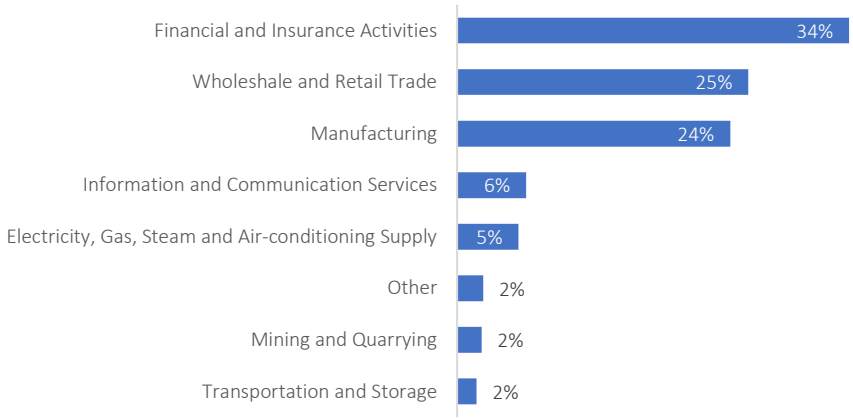
Among Turkic Council Member States, with 2,518 registered companies, Azerbaijan was ranked in 7th place among countries with the highest number of foreign affiliates in Turkey. Companies of Azerbaijan are experienced in the oil and gas sector. Azerbaijan's national energy champion SOCAR owns several strategically important oil and gas assets in Turkey, including the STAR refinery, Turkey's largest oil refinery. As of October 2020, 620 companies registered in Turkey were affiliated with Kazakhstan, 348 with Uzbekistan, and 237 with Kyrgyzstan.

According to fDi Markets, Turkey became the 7th most popular FDI destination in Europe in 2019. Still, Turkey acknowledges that it needs to encourage more robust FDI inflows to meet

its ambitious development goals and finance its current account deficit. According to the Central Bank of the Republic of Turkey, by the end of 2019, 68.6% of FDI inflow stock went to Turkey's services sector, 31% to industrial sectors, and 0.3% to agriculture. The share of financial and insurance activities in inward FDI stock was 34%. Retail trade (25%) and manufacturing (24%) were other most significant sectors in attracting FDI to Turkey (Figure 5.28).

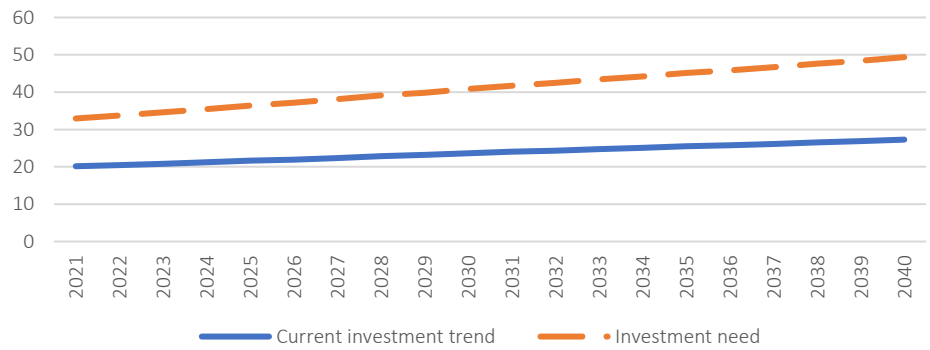
When it comes to Turkey's outward FDI stock, according to the Central Bank of the Republic of Turkey, Turkish businesspeople have mostly invested abroad in financial and insurance activities (77%) and manufacturing (11%).

Figure 5.28: FDI Inflow Stock in Turkey by Sectors (2019, percent)



Source: Central Bank of the Republic of Turkey, EVDS Data Central (NACE, Rev.2)

Figure 5.29: Projection of Total Infrastructure Investments in Turkey (Billion US$)



Source: Global Infrastructure Hub, Infrastructure Outlook, https://outlook.gihub.org.

According to projections of Global Infrastructure Hub and Oxford Economics, from 2021 to 2040, Turkey may face a $348,7 billion gap in financing necessary infrastructure investments

(Figure 5.29). Estimates based on the current investment trend show that by 2040 Turkey will invest $474.6 billion in transportation, telecommunication, energy, and water infrastructure. However, projected cumulative infrastructure needs by 2040 are $823.2 billion. A total investment gap of $348.7 billion is expected to originate from investment needs in the roads ($288.3 billion), energy ($41.6 billion), rail ($16.2 billion), water ($1.9 billion), and airports ($0.6 billion).

Table 5.5: Cumulative Infrastructure Investments in Turkey **(2021-2040, billion US$)**

	Road	Rail	Airports	Ports	Telecoms	Energy	Water	Total
2021-2040 (Current investment trends - CIT)	137,3	36,6	14,7	0,8	80,9	161,3	42,9	474,6
2021-2040 (Investment need - IN)	425,6	52,8	15,3	0,9	80,9	202,9	44,8	823,2
2021-2040 (Gap between IN and CT)	288,3	16,2	0,6	0,0	0,0	41,6	1,9	348,7

Source: Global Infrastructure Hub, Infrastructure Outlook, https://outlook.gihub.org.

Turkic Council Member States should make the best use of their comparative advantages and increase investments among themselves, thus contribute to the further diversification of the national economies, and development of the infrastructure needs.

CHAPTER

VI

Analysis of Investment Climate and Major Impediments to Investment

6 Analysis of Investment Climate and Major Impediments to Investment

This chapter provides a comparative overview of the state of the investment climate in TC-4 countries, aiming to identify challenges that create barriers for investment, deteriorate investors' perceptions, and reduce the attractiveness for foreign direct investment (FDI). In this regard, the chapter first focuses on the ease of doing business by using the World Bank's Ease of Doing Business Index and then looks at the constraints to investment at firm level by benefiting from various datasets. Finally, the chapter analyses some risk indices such as the OECD Risk Score to reveal the level, type, and scope of potential risks and uncertainties that emerge as impediments to investment in TC-4 countries.

6.1 Ease of Doing Business

FDIs play an essential role in promoting growth and sustaining development in TC-4 economies. The productivity gains that result from product and process innovation brought about through investments are critical to consider in attracting investments (World Bank, 2004). In this regard, the investment climate consequently needs to provide opportunities and incentives for firms and entrepreneurs to develop and adopt better ways of doing business. In other words, the current investment climate affects both the quality and quantity of investments. An investment climate conducive for new investments triggers economic growth and helps the transition of economic sectors and actors to a higher level of development.

Against this backdrop, the investment climate in TC-4 countries can be assessed using the Ease of Doing Business (EDB) Index of the World Bank that provides unique and comparable information useful in cross-country comparisons.

The EDB index is meant to measure regulations directly affecting businesses and does not directly measure general conditions such as a nation's proximity to large markets, quality of infrastructure, inflation, or crime. A nation's ranking on the index is based on the average of 10 sub-indices:

1. Starting a business – Procedures, time, cost, and minimum capital to open a new business;
2. Dealing with construction permits – Procedures, time, and cost to build a warehouse;
3. Getting electricity – procedures, time, and cost required for a business to obtain a permanent electricity connection for a newly constructed warehouse;
4. Registering property – Procedures, time, and cost to register commercial real estate;

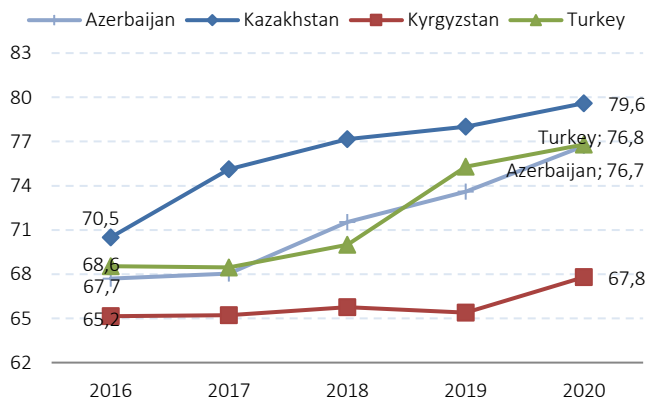
5. Getting credit – Strength of legal rights index, depth of credit information index;
6. Protecting investors – Indices on the extent of disclosure, the degree of director liability, and ease of shareholder suits;
7. Paying taxes – Number of taxes paid, hours per year spent preparing tax returns, and total tax payable as a share of gross profit;
8. Trading across borders – Number of documents, cost and time necessary to export and import;
9. Enforcing contracts – Procedures, time, and cost to implement a debt contract; and
10. Resolving insolvency – The time, cost, and recovery rate (%) under bankruptcy proceeding.

Although the EDB indicators measure business regulations and their enforcement, especially from the perspective of small to medium-size domestic firms, the overall index score gives a good idea about the quality of investment climate both for domestic and foreign investors as they need to complete similar formalities in many steps of their operations.

In presenting the results of the doing business indicators, the World Bank utilizes the "Distance to Frontier" concept. The distance to frontier shows each economy's distance to the "frontier," representing the best performance observed on each of the indicators across all economies in the Doing Business dataset. An economy's distance to frontier is reflected on a scale from 0 to 100, where '0' represents the lowest performance, and '100' represents the frontier.

Figure 6.1 shows the average value of the ease of doing business indicator for TC-4 countries over 2016-2020. The business environment in all TC-4 economies has improved over this period. The average index values climbed up compared to their values recorded in 2016. Kazakhstan improved its score the most that went up from 70.5 in 2016 to 79.6 in 2020. In this regard, Azerbaijan closely followed Kazakhstan, where its average score increased from 67.7 in 2016 to 76.7 in 2020. According to the degree of recorded progress, Turkey ranked third among TC-4 countries, whose average score peaked at 76.8 in 2020. Finally, Kyrgyzstan also slightly improved its business climate as its score went up from 65.2 in 2016 to 67.8 in 2020. As of 2019, among TC-4 economies, Kazakhstan had the most favorable business climate for doing business,

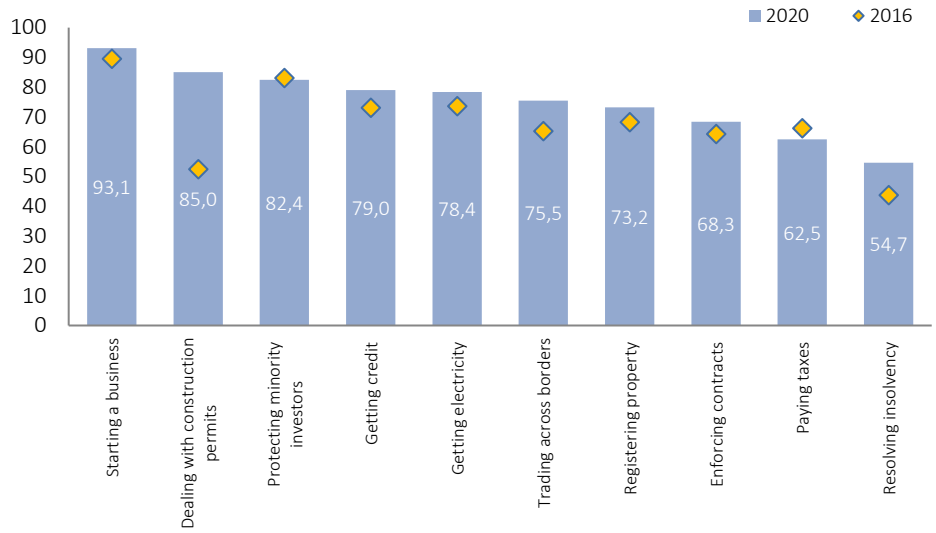
Figure 6.1: Ease of Doing Business Index Scores



Source: World Bank, Ease of Doing Business database.
Score values: 0 (worst)-100 (best).

according to the EDB index scores. Looking at the average sub-index score performances provides additional insights regarding the obstacles and barriers for doing business in TC-4. In this regard, Figure 6.2 presents the average performance of TC-4 countries, comparing the years 2016 and 2020 in the sub-index scores.

Figure 6.2: The Average Scores in Sub-Indicators of the Ease of Doing Business Index (2016 versus 2020)



Source: World Bank, Ease of Doing Business database. Score values: 0 (worst)-100 (best).

The first observation regarding the sub-indexes presented in Figure-6.2 is that TC-4 countries managed to progress in many areas, except for paying taxes and protecting minority investors indicators. In 2020, the best average scores of TC-4 countries were achieved in starting a business (93.1) and dealing with construction permits (85), whereas resolving insolvency (54.7) and paying taxes (62.5) were areas with the lowest scores.

The subindex on resolving insolvency looks at the time, cost, and outcome of insolvency proceedings involving domestic entities, as well as the strength of the legal framework applicable to judicial liquidation and reorganization proceedings. Resolving insolvency is the dimension with the lowest average score obtained by TC-4 countries. Nevertheless, considerable progress in this score is evident, which increased from 43.7 in 2016 to 54.7 in 2020.

Paying taxes indicator records the taxes and mandatory contributions that a medium-size company must pay or withhold in a given year, as well as the administrative burden of paying taxes and contributions. The average paying taxes score for Europe and Central Asia was 77.9 in 2020. The subindex on enforcing contracts measures the time and cost for resolving a commercial dispute through a local first-instance court and the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote

quality and efficiency in the court system. Overall, the judicial system's efficiency in resolving a commercial dispute is also highly critical in improving the business and investment climate. Enforcing contracts seems to emerge as another problematic area in doing business in TC-4, where the average score could not reach 70 both in 2016 and 2020.

On the other side of the spectrum, TC-4 countries, on average, have a very favorable environment in starting a business. On average, there are not many time and money consuming procedures to start a business. In this dimension, a further improvement was recorded between 2016 and 2020, that the average score reached 93.1. On average, in TC-4 countries, dealing with construction permits seems easy, given the average score of 85 in 2020. On average, TC-4 countries recorded remarkable progress in this dimension between 2016 and 2020.

TC-4 countries made good strides to improve their business and investment climate in recent years. This progress is reflected in their average scores in the ease of doing business index scores and its subindex scores. These improvements do not fall from the sky and stem from well-planned and implemented reforms to overcome barriers that constitute an impediment to doing business. In this regard, Table 6.1 summarizes the reforms in TC-4 countries for the 2017-2019 period in all areas of the ease of doing business index. Azerbaijan made reforms in eight areas in 2017-2018. It was followed by Turkey that made reforms in seven areas in the same period. Both Kazakhstan and Kyrgyzstan exerted efforts to implement reforms in four areas over 2017-2018. However, the information provided for the 2018-2019 period reflects the slowing down of reforms in TC-4 countries to ease doing business. The details of progress in reforms and deteriorating conditions for the 2018-2019 period are reported in Annex of this Chapter.

Table 6.1: Completed Reforms to Ease Doing Business

Reform Areas	Azerbaijan		Kazakhstan		Kyrgyzstan		Turkey	
	2017-2018	2018-2019	2017-2018	2018-2019	2017-2018	2018-2019	2017-2018	2018-2019
Starting a business			Yes	Yes			Yes	
Dealing with construction permits	Yes			Yes			Yes	
Getting electricity	Yes		Yes			Yes		
Registering property	Yes	Yes		No			No	Yes
Getting credit	Yes	Yes		Yes		Yes	Yes	
Protecting minority investors	Yes	Yes			Yes			
Paying taxes	Yes	No				Yes	Yes	Yes
Trading across borders	Yes		Yes		Yes		Yes	
Enforcing contracts		Yes	Yes		Yes		Yes	
Resolving insolvency	Yes			No	Yes		Yes	

Source: World Bank, Ease of Doing Business database, https://www.doingbusiness.org/en/reforms.
Note: "No" means that the related indicator's conditions have become more difficult in the given period.

As the competition among developing countries increases, TC-4 should accelerate reforms in easing doing business. Moreover, establishing a practical cooperation framework among the Member States on related reform areas would lead to the effective exchange of expertise, knowledge, and best-practices and drive Turkic Council Cooperation to greater heights.

6.2 Perceived Constraints to Investment at Firm Level

This sub-section focuses on perceived constraints to investment, especially at the firm level, by analyzing several selected indicators, including the Logistics Performance Index (LPI) and World Bank's World Enterprise Survey.

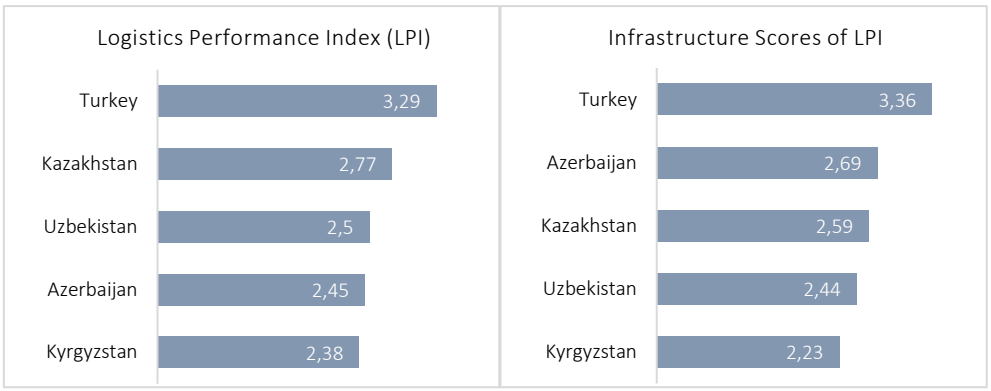
For multinational companies and international investors, host countries' connectivity is vital to ensure uninterrupted exports and imports of raw, intermediate, and final goods and services throughout their operations. Moreover, connectivity networks affect growth potentials not only in host economies but also in their wider regions. In this regard, firms' constraints regarding transportation systems and networks could be essential barriers for FDI and multinational companies' operations, given their backward and forward linkages.

The state of existing transportation systems and networks can be assessed either directly through looking at indicators such as road and railway densities or indirectly by investigating the composite indices such as the Logistics Performance Index (LPI). The LPI ranks countries on six dimensions:

- The efficiency of customs and border management clearance ("Customs");
- The quality of trade and transport infrastructure ("Infrastructure");
- The ease of arranging competitively priced shipments ("Ease of arranging shipments");
- The competence and quality of logistics services - trucking, forwarding, and customs brokerage ("Quality of logistics services");
- The ability to track and trace consignments ("Tracking and tracing"); and
- The frequency with which shipments reach consignees within scheduled or expected delivery times ("Timeliness").

The LPI uses standard statistical techniques to aggregate the data into a single indicator used for cross-country comparisons. It takes values between 1 and 5, where a score of 5 shows the highest development level of logistics performance. A country with improved logistics performance tends to have an improved transportation network and infrastructure. According to the LPI scores reported in Figure 6.3, Turkey obtained the highest score (3.29) and was followed by Kazakhstan (2.77), Uzbekistan (2.5), and Azerbaijan (2.45) in 2018. Kyrgyzstan had the lowest LPI score (2.38) among the Member States in the same year. Turkic Council Member States' LPI scores were higher than scores of other Central Asian countries (Turkmenistan-2.34, Tajikistan 2.29). In terms of the infrastructure subindex score of the LPI, again Turkey was the leading country with a score of 3.36 and was followed by Azerbaijan (2.69).

Figure 6.3: Logistics Performance Index (LPI) - 2018



Source: Logistics Performance Index, World Bank.
Note: Infrastructure scores refers to the quality of trade and transport infrastructure.

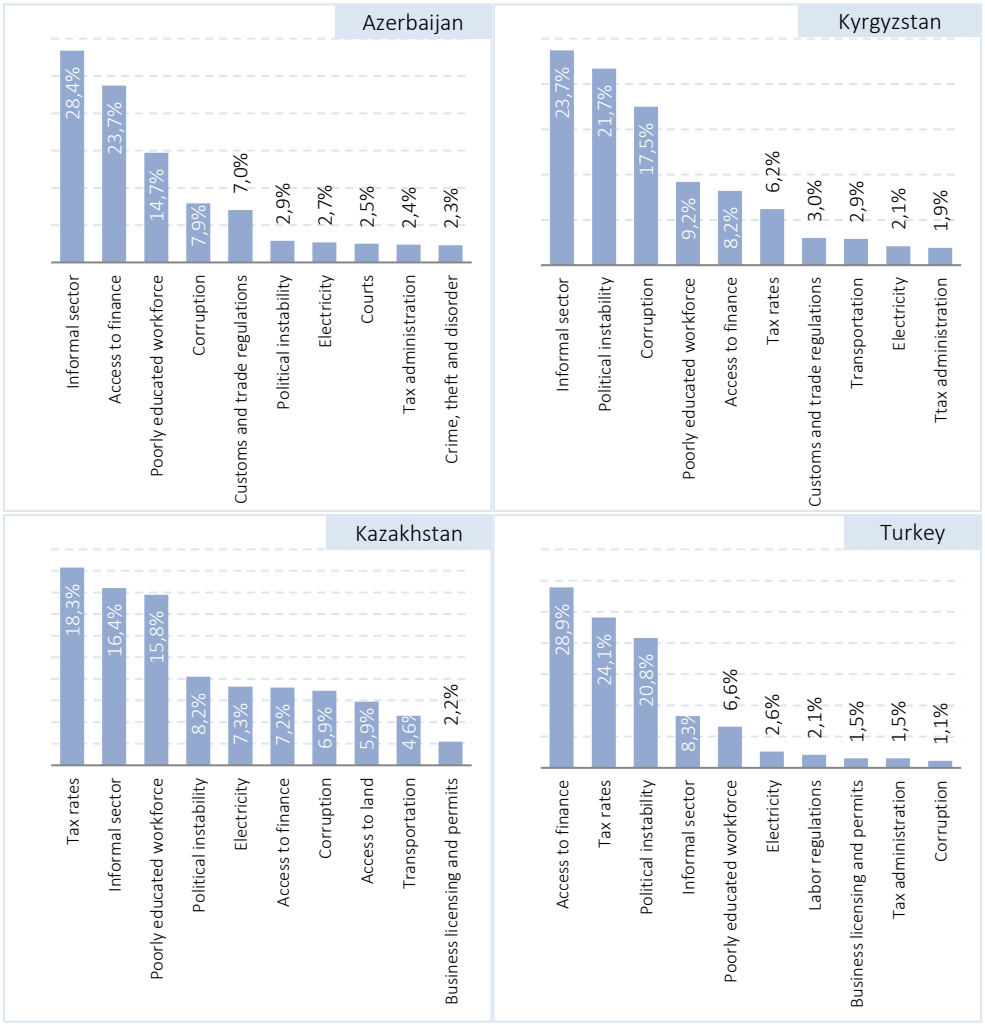
The LPI scores in Figure 6.3 revealed that Turkic Council Member States need to exert efforts to improve their transportation networks and increase connectivity by investing in infrastructure and embarking on cross-border transportation projects. The Turkic Council would be essential in sharing knowledge and expertise among the Member States in this particular area of concern critical for investors.

Perceived constraints to investment at the firm level can be best assessed by using firm-level data that reflect companies' views regarding the barriers and constraints they face in day-to-day operations on investments. In this context, Figure 6.4 reports the World Bank's Enterprise Survey conducted in 2019 in TC-4 countries. The survey questions aimed at identifying the major obstacles for firms in the business environment that ultimately affect their decision to invest. In Azerbaijan, the informal sector practices and access to finance emerged as two leading obstacles for firms. About 52% of Azerbaijan companies, who responded to the survey, reported these two issues as the most significant obstacles. Limited access to finance tends to reduce SMEs' growth potentials and negatively impact FDI (Ayyagari et al., 2017). In Kazakhstan, tax rates (18.3%) and informal sector (16.4%) seem to be identified by firms as two major obstacles that impede doing business and making investments. In Kyrgyzstan, the informal sector was chosen by 23.7% of firms as an obstacle, and about 20% of firms said that political instability is a significant concern in doing business and making investment decisions.

Finally, 28.9% of firms that responded to the Turkey survey reported that access to finance is a significant obstacle. About 24.1% of firms said that tax rates create a hurdle for them in the business environment that needs to be addressed. Even though the ranking of ten major obstacles in TC-4 countries varies, some commonalities and concerns seem to be mentioned more than others. For example, the informal sector was reported as one of the most critical obstacles in Azerbaijan, Kazakhstan, and Kyrgyzstan. Access to finance appears as a significant obstacle for business in Turkey and Azerbaijan. Tax rates are were perceived as a considerable obstacle in Kazakhstan and Turkey. These findings would give some hints to identify priority reform areas in TC-4 economies to improve the individual country's investment climate.

Moreover, as some of these obstacles were reported frequently by many firms, some joint efforts can be put forward by the Turkic Council to address them in cooperation and benefit from Member States' national experiences and success stories.

Figure 6.4: Top Ten Obstacles Perceived by Firms (2019)



Source: World Bank, Enterprise Survey, http://www.enterprisesurveys.org.
Number of firms surveyed: Azeribajan-225, Kazakhstan-1446, Kyrgyzstan-360 and Turkey-1663.

6.3 Potential Risks and Uncertainties

Investors would like to benefit from opportunities available all around the globe to maximize their profits. Nevertheless, they do not like risks and uncertainties that could constitute a threat to their investment or limit their maneuver areas, such as restricting profit transfers or

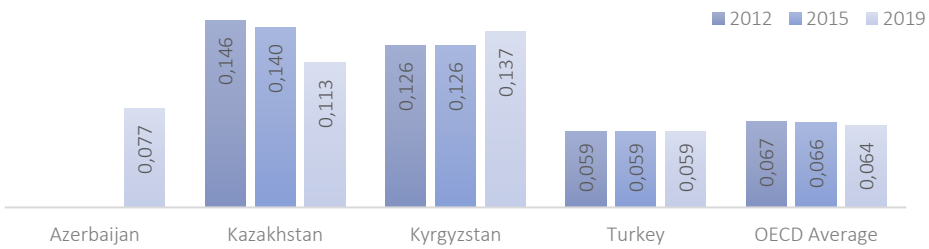
currency exchange. Therefore, they conduct a series of risk evaluations before making any decision to invest.

Amongst others, FDI rules and regulations are a critical determinant of a country's attractiveness to foreign investors. In this context, the FDI Regulatory Restrictiveness Index (FDI Index) developed by OECD measures statutory restrictions on FDIs in 22 economic sectors (Kalinova et al., 2010). The FDI Index gauges the restrictiveness of a country's FDI rules by looking at the four main types of restrictions on FDI:

- Foreign equity limitations;
- Screening or approval mechanisms;
- Restrictions on the employment of foreigners as key personnel; and
- Operational restrictions, e.g., restrictions on branching and capital repatriation or land ownership.

The FDI Index is not a full measure of a country's investment climate. However, it gives an overall idea regarding the potential risks and uncertainties for foreign investors. A lower index score implies lesser levels of restrictiveness. In this regard, Figure 6.5 reports the FDI Regulatory Restrictiveness Index's total scores for TC-4 countries and compares them with the OECD average over 2012-2019. Turkey obtained the lowest score among TC-4 countries, and its score (0.059) was even found to be lower than the OECD average (0.066) in 2019. Between 2012 and 2019, the score of Turkey remained stable. Azerbaijan is closely following Turkey with a score of 0.77, and it is close to the OECD average.

Figure 6.5: OECD FDI Regulatory Restrictiveness Index Total Scores



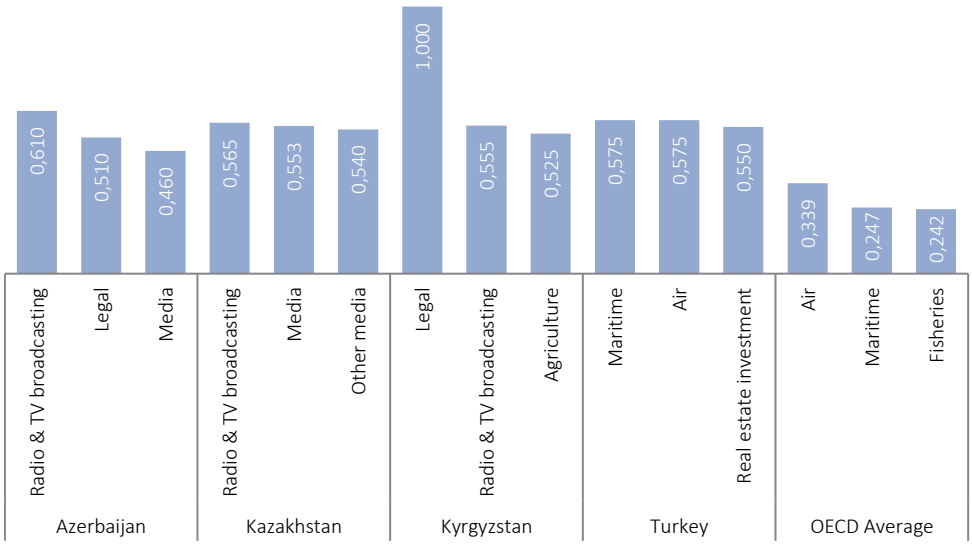
Source: OECD, https://stats.oecd.org/Index.aspx?DataSetCode=FDIINDEX.
Note: Data for Azerbaijan available only for 2019. The highest score is 1 (the measures fully restrict foreign investment) and the lowest is 0 (there are no regulatory impediments to FDI).

Kazakhstan made remarkable progress in the observed period. Its score went down from 0.146 in 2012 to 0.113 in 2019, reflecting a reduction in foreign investors' restrictions. A slight increase in the level of FDI restrictions was observed in Kyrgyzstan during this period. Its score climbed up from 0.126 in 2012 to 0.137 in 2019. Both the scores of Kazakhstan and Kyrgyzstan are well above the averages of OECD.

Keeping in mind that the highest score is 1 (the measure entirely restricts foreign investment) and the lowest is 0 (there are no regulatory impediments to FDI), with the given scores, it could be concluded that the overall FDI regulatory framework in TC-4 countries is mostly liberated.

Still, the results imply that the Member States with higher scores need to continue with efforts to overcome regulatory barriers to investments in order to attract more FDI. The Turkic Council could encourage the Member States to work together and share their experiences in overcoming FDI restrictions.

Figure 6.6: Top Three Most Restrictive Sectors for FDI
(2019, based on sectoral FDI restrictiveness index scores)



Source: OECD, https://stats.oecd.org/Index.aspx?DataSetCode=FDIINDEX.
Note: The highest score for any measure in any sector is 1 (the measure fully restricts foreign investment in the sector) and the lowest is 0 (there are no regulatory impediments to FDI).

Figure 6.6 displays the top three most restrictive sectors for FDI in TC-4 economies in 2019. According to the OECD FDI Regulatory Restrictiveness Index, the most restrictive sectors in Azerbaijan were radio & TV broadcasting, legal services, and media. In Kazakhstan, radio & TV broadcasting, media, and other media sectors were found to be with the highest level of regulatory restrictions for foreign investment. In Kyrgyzstan, legal services were entirely restricted for FDIs. Radio & TV broadcasting and agriculture were identified as other Kyrgyzstan sectors with relatively higher regulatory restrictions for foreign investment. In Turkey, the top three restrictive sectors for FDI were maritime, air, and real estate in 2019. On average, in OECD countries, air, maritime, and fisheries emerged as the top three restrictive sectors in 2019. Overall, the sectoral analysis revealed some information regarding restrictions in some sectors that limit FDI inflows. This provides some hints to policymakers on which

sectors should prioritize while removing specific restrictions and obstacles in the Member States.

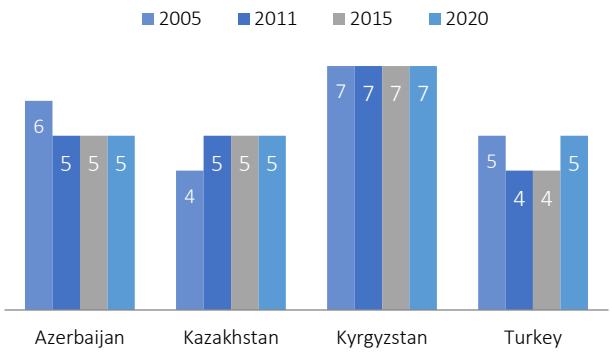
Country Risk Classification of the OECD

The country risk classifications are meant to reflect the country risk that encompasses transfer and convertibility risk (i.e., the risk a government imposes capital or exchange controls that prevent an entity from converting local currency into foreign currency and/or transferring funds to creditors located outside the country) and cases of force majeure (e.g., war, expropriation, revolution, civil disturbance, floods, earthquakes).

The country risk classification (CRC) database has become an important indicator used by investors, researchers, multilateral institutions, and public officials to track and monitor the prevailing risks in countries across the globe. The indicator takes values between 0 and 7 by applying a two-step methodology comprising both quantitative and qualitative assessment. A higher value represents higher risk exposure for investors (see OECD, 219b).

Although the overall country risk has many implications for domestic investors, it influences foreign investors' decisions to a greater extent. Foreign investors tend to make a higher level of direct investments in countries with lower country risk classification scores. Suppose they intend to invest countries with high-risk scores. In that case, foreign investors usually have to pay a very high premium to insure their investment.

Figure 6.7: OECD Country Risk Classification



Source: OECD Country Risk Classification Dataset, Version: 29 January 2021. Risk score scale: 0 (lowest risk)- 7 (highest risk).

According to Figure 6.7, TC-4 countries obtained scores between 4 and 7 over 2005-2020. Azerbaijan decreased its score from 6 in 2005 to 5 in 2011, and it maintained it at the same level in 2020. Kazakhstan's risk score went up from 4 in 2005 to 5 in 2011 and stayed at this level as of 2020. The score of Kyrgyzstan remained unchanged at the level of 7. Turkey maintained its score in the range of 4 to 5 during this period, and as of 2020, it was identified as 5. Overall, as of 2020, TC-4 countries did not have a lower score than 5, while Kyrgyzstan's score is very high (7), which is the highest possible risk score. In this picture, TC-4 countries should work together to reduce their country risk scores and provide a business environment with limited risks and uncertainties for investors.

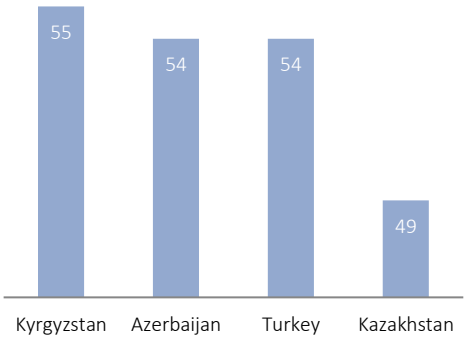
Country Risk Classification of the Economist Intelligence Unit

There are several risk assessment indicators for countries that investors use. They use such indicators before deciding on investment in a foreign country. One of the most well-known indicators used in the literature is the risk score calculated by the Economist Intelligence Unit (EIU), which looks at the following ten dimensions to determine a country's risk score:

1. Security risk;
2. Tax policy risk;
3. Infrastructure risk;
4. Macroeconomic risk;
5. Foreign trade & payments risk;
6. Financial risk;
7. Labor market risk;
8. Legal & regulatory risk;
9. Political stability risk; and
10. Government effectiveness risk.

A higher score implies to higher risk, and the maximum score that can be obtained is 100. According to Figure 6.8, Kazakhstan received the lowest score (49) among TC-4 countries in 2018. It was followed by Turkey (54) and Azerbaijan (54), and Kyrgyzstan obtained a score of 55. Figure 6.9 depicts the distribution of risk scores. In Azerbaijan, Kazakhstan, and Kyrgyzstan, the government effectiveness risk score was the highest in 2018, according to EIU.

Figure 6.8: The EIU Risk Classification (2018)

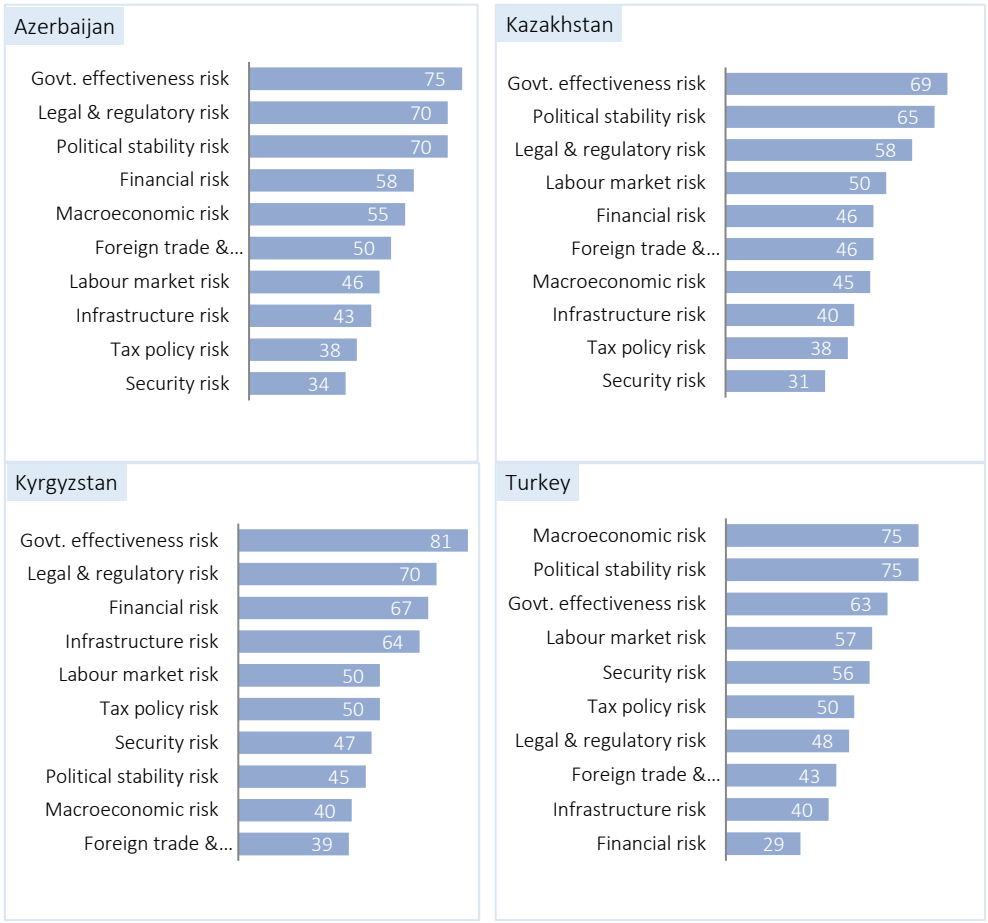


Source: The Economist Intelligence Unit database. Risk score scale: 0 (lowest risk) - 100 (highest risk).

The legal and regulatory risk was placed among the top three areas of concern in Azerbaijan, Kazakhstan, and Kyrgyzstan. In a similar vein, political stability was identified as an area with a relatively high-risk score in Azerbaijan, Turkey, and Kazakhstan. In Turkey, the macroeconomic risk score was very high (75), whereas it was relatively low in Kyrgyzstan (40). On the other hand, the security risk scores of Azerbaijan (34) and Kazakhstan (31) were the lowest (less risky) among TC-4 countries. The detailed risk scores reveal that investors and firms face some risks in their business life in TC-4 countries. Moreover, some of these areas with high risks are similar across the Member States. In this regard, Member States may join their forces to find ways to address these common areas of concern by benefiting from the cooperation under the Turkic Council's umbrella. In particular, each country has unique experiences and best practices. For instance, Turkey has a good experience in managing

financial risks, whereas the experiences of Kazakhstan and Azerbaijan on minimizing tax policy risk are essential to consider.

Figure 6.9: Distribution of EIU Risk Scores (2018)



Source: The Economist Intelligence Unit. Risk score scale: 0 (lowest risk)- 100 (highest risk).

Country Watch's Foreign Investment Index

The Foreign Investment Index is a proprietary index measuring attractiveness to international investment flows. The Foreign Investment Index is calculated using an established methodology by Country Watch and is based on a given country's economic stability (sustained economic growth, monetary stability, current account deficits, budget surplus), economic risk (risk of non-servicing of payments for goods or services, loans and trade-related finance, risk of sovereign default), business and investment climate (property rights, labor force and laws, regulatory transparency, openness to foreign investment, market conditions, and stability of government). Scores are assigned from 0-10. According to this proprietary

Figure 6.10: Foreign Investment Index (2020)

Source: Country Watch data, www.countrywatch.com
Note: A score of 0 marks the lowest level of foreign investment viability, while a score of 10 marks the highest level of foreign investment viability.

index, a score of 0 marks the lowest level of foreign investment viability, while a score of 10 marks the highest level of foreign investment viability. As shown in Figure 6.10, in 2020 Foreign Investment Index score was highest for Turkey (7) and was followed by Kazakhstan (6), Azerbaijan (5), and Kyrgyzstan (4.5)

Overall, the governments of TC-4 countries overtly encourage foreign investment. That said, foreign investors face significant obstacles. This chapter's figures suggest that there is a place for improvements in setting up more favorable frameworks for foreign businesses in many areas and sectors of the Member States. It is recommended to the Member States to take necessary measures in identified sectors and foster an environment conducive to attracting more foreign investments. For that to happen, reforms are needed to improve the business climate and introduce investment incentives tailored to domestic and foreign investors' needs. This, in turn, requires building adequate infrastructure and investing in modern technologies to enhance productive capacities.

ANNEX TO CHAPTER 6

Selected Completed Reforms to Ease Doing Business in 2018-2019

✓ Doing Business reform making it easier to do business.

✗ Change making it more difficult to do business.

Azerbaijan

✓ *Registering Property:* Azerbaijan made registering property easier and more transparent by increasing the coverage of its cadaster and digitizing cadastral plans. Azerbaijan also made property transfer more difficult by making it mandatory to deposit funds into the notary deposit account.

✓ *Getting Credit:* Azerbaijan strengthened access to credit by allowing non-possessory security interests in one category of movable assets without any restrictions on the use of inventory, including future assets extending automatically to products, proceeds and replacements of the original collateral. Azerbaijan also allowed general description of the debts and obligations as well as out-of-court enforcement of security interests.

✓ *Protecting Minority Investors:* Azerbaijan strengthened minority investor protections by imposing liability on directors for unfair related-party transactions.

✗ *Paying Taxes:* Azerbaijan made paying taxes more difficult by adding a new labor contribution.

✓ *Enforcing Contracts:* Azerbaijan made enforcing contracts easier by introducing an e-system that allows plaintiffs to file the initial complaint electronically and by adopting a consolidated law on voluntary mediation.

Kazakhstan

✓ *Starting a Business:* Kazakhstan made starting a business easier by registering companies for value added tax at the time of incorporation.

✓ *Dealing with Construction Permits:* Kazakhstan made dealing with construction permits easier by streamlining the expert evaluation of the construction project and by improving the process for obtaining a new water connection.

✗ *Registering Property:* Kazakhstan made registering property cheaper by decreasing registration fees. Kazakhstan also made transferring property more difficult by requiring additional proof of payment of state duties.

✓ *Getting Credit:* Kazakhstan strengthened access to credit by automatically extending security interests to the products, proceeds and replacements of the original assets and by giving secured creditors absolute priority during insolvency proceedings. Kazakhstan also improved access to credit information by reporting credit data from retailers.

✗ *Resolving Insolvency:* Kazakhstan made resolving insolvency more difficult by requiring that all creditors vote on the rehabilitation plan, regardless of its impact on their interests.

Kyrgyzstan

✓ *Getting Electricity:* Kyrgyzstan improved the reliability of power supply by enhancing the monitoring of outages and modernizing its infrastructure to reduce power outages.

✓ *Getting Credit:* Kyrgyzstan improved access to credit information by providing credit scores to banks, financial institutions and borrowers.

✓ *Paying Taxes:* Kyrgyzstan made paying taxes easier by consolidating the tax on interest income into the corporate income tax and by introducing an online platform for filing and paying taxes.

Turkey

✓ *Registering Property:* Turkey made property registration less expensive by temporarily reducing mortar charges to transfer property, and faster by reducing the time to obtain a tax assessment.

✓ *Paying Taxes:* Turkey made paying taxes easier by amending the value added tax code to exempt certain capital investments from value added tax.

Source: Adapted from Doing Business Report 2020.

CHAPTER

VII

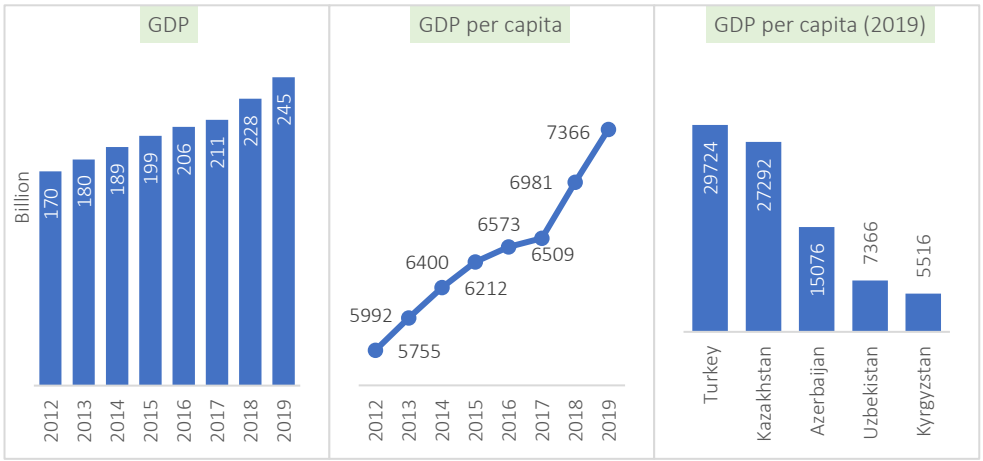
Uzbekistan: New Member, New Impetus

7. Uzbekistan: New Member, New Impetus

During the 7th Summit held in Baku in October 2019, Uzbekistan has officially joined the Cooperation Council of Turkic Speaking States. As a vibrant economy with excellent prospects for economic complementarity and partnership, its access to the Council is expected to stimulate a new impetus to promote deeper relations and solidarity amongst the Member States.

With its nearly 33,6 million population in 2019, Uzbekistan became the second most populous Turkic Council Member State after Turkey (83,4 million in 2019). The Member States' total population exceeded 152 million in 2019, significantly contributing to expanding the market potential. Uzbekistan has been a very dynamic economy with constant growth in economic activities. Its PPP-based GDP reached $245 billion in 2019, compared to $170 billion in 2012 (Figure 7.1, left). PPP-based GDP per capita of Uzbekistan income has also increased from $5755 to $7366 during the same period, corresponding to almost 22% growth in 8 years (Figure 7.1, middle).

Figure 7.1: GDP and GDP per Capita of Uzbekistan (PPP, current int. $)

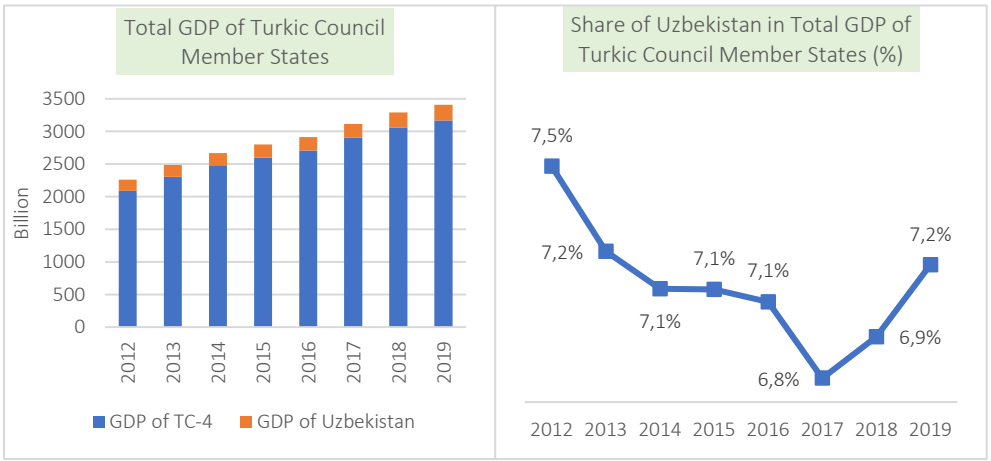


Source: IMF, World Economic Outlook, October 2020 update.
Note: GDP and GDP per capita based on purchasing power parity (PPP) at current international dollars.

Compared with other Turkic Council Member States, Uzbekistan has a relatively lower per capita income. Uzbekistan's PPP-based GDP per capita at $7366 in 2019 was higher than the per capita income level in Kyrgyzstan but much lower than per capita incomes in Turkey, Kazakhstan, and Azerbaijan (Figure 7.1, right). Greater economic cooperation and integration are expected to reduce the income disparity across the countries by facilitating economic diversification and growth in lower-income countries.

With Uzbekistan's membership, the Turkic Council Member States' aggregated PPP-based GDP has reached $3.4 trillion in 2019 (Figure 7.2, left). Share of Uzbekistan in total GDP of Turkic Council Member States took values between 6.8%-7.5% from 2012 to 2019, which corresponds to 7.2% in 2019. From 2017 to 2019 share of Uzbekistan in the total GDP of Member States is continuously growing (Figure 2.2, right). Uzbekistan can provide a new stimulus to economic cooperation and partnership endeavors among the Member States through its vibrant economic structure.

Figure 7.2: Contribution of Uzbekistan to Total GDP of Turkic Council Member States (PPP, current int. $)



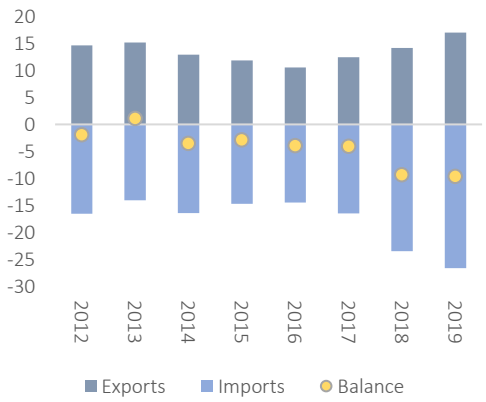
Source: IMF, World Economic Outlook, October 2020 update.
TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey.

7.1 Trade Integration

Total exports of Uzbekistan to the world have been growing since 2016 and reached $17 billion in 2019. However, its imports remain continually higher than its exports, resulting in a trade deficit. From 2012 to 2019, the trade deficit of Uzbekistan averaged $4.2 billion. In 2019, the negative trade balance was recorded at $9.6 billion (Figure 7.3)

Uzbekistan's contribution to the total exports and imports of Turkic Council Member States appears relatively lower than its contribution to

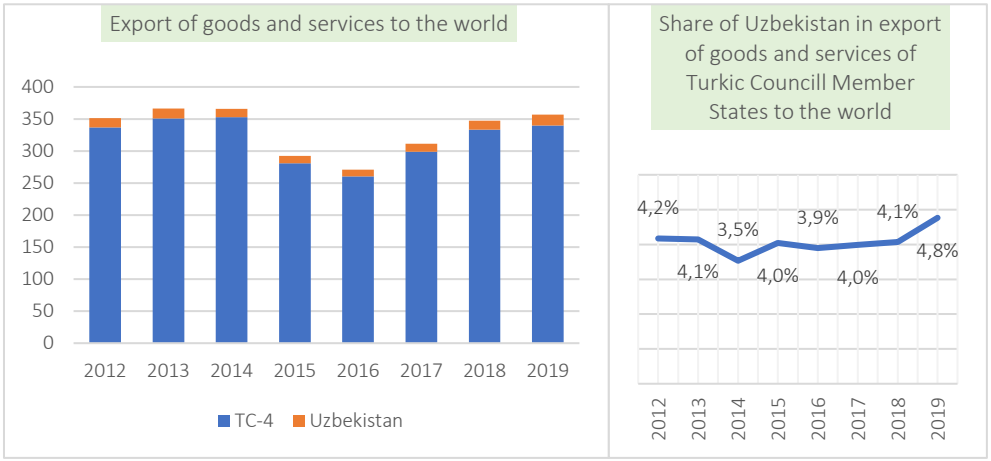
Figure 7.3: Uzbekistan's Exports and Imports of Goods and Services (Billion $US)



Source: UNCTADSTAT.

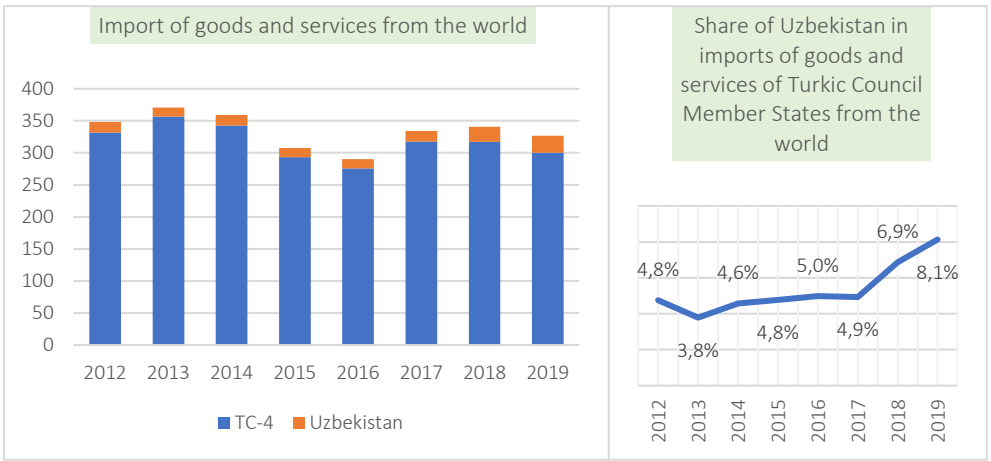
Member States' aggregated GDP. According to UNCTAD data, total exports of goods and services of Member States to the world accounted to $356.6 billion in 2019. The share of Uzbekistan in exports was 4.8% in the same year (Figure 7.4). On the other hand, from 2012 to 2019, the average share of Uzbekistan in total imports of goods and services of Member States from the world was around 5.3%. In 2019, Member States' total imports of goods and services from the world was $326.1 billion, out of which $26.6 billion, or 8.1% belonged to Uzbekistan (Figure 7.5).

Figure 7.4: Contribution of Uzbekistan to the Member States' Total Exports of Goods and Services to the World (Billion $US)



Source: UNCTADSTAT.
TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey.

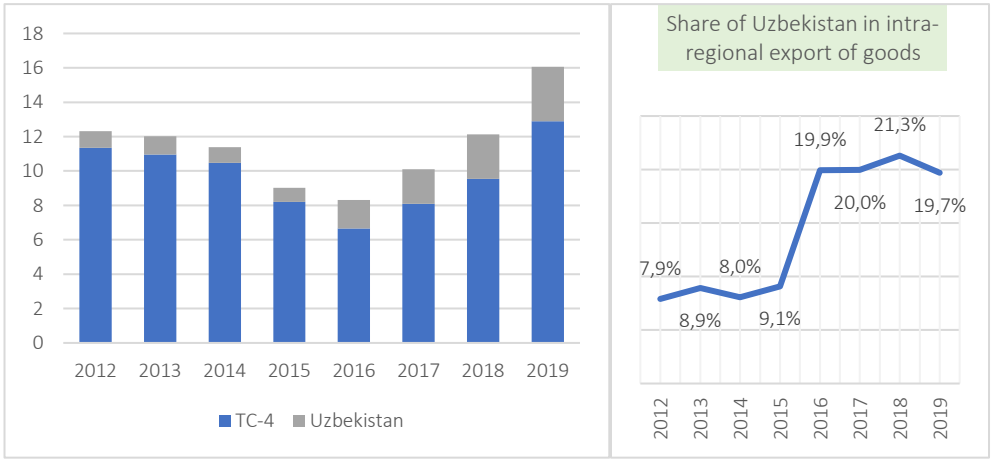
Figure 7.5: Contribution of Uzbekistan to the Member States' Total Imports of Goods and Services from the World (Billion $US)



Source: UNCTADSTAT.
TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey.

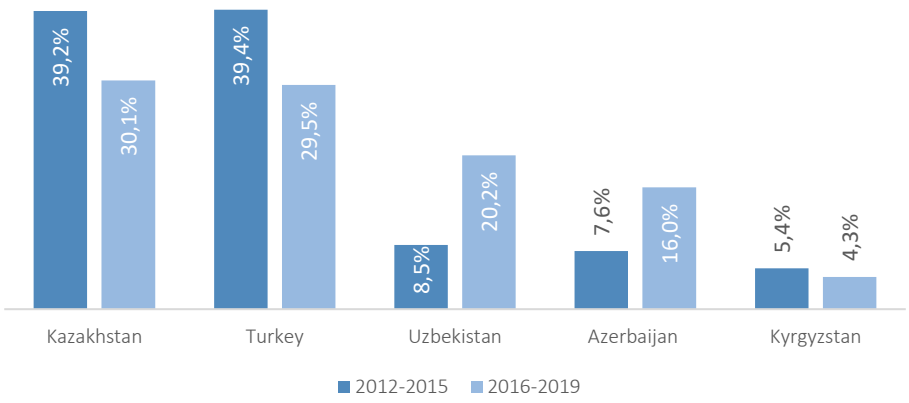
In terms of intra-regional trade, Uzbekistan makes a meaningful contribution to total intra-regional exports. Over the period from 2016 to 2019, Uzbekistan's contribution has increased exports among Member states by near 20%. In 2019, the total volume of intra-regional exports reached $16.1 billion, out of which $3.2 billion belonged to Uzbekistan (Figure 7.6 left). It could be argued that Uzbekistan is well integrated into trade among the Member States, with continuously increasing export volumes (Figure 7.6 right).

Figure 7.6: Intra-TC Export of Goods (Billion $US)



Source: IMF DOTS.
TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey.

Figure 7.7: Country Shares in Intra-Regional Export of Goods (Percent)



Source: IMF DOTS. Intra-TC Export of Goods covers total exports of Turkic Council Member States.

Averages of 2012-2015 and 2016-2019 show that exports of Kazakhstan dominate in intra-regional exports. However, Kazakhstan's share decreased from 39.2% in 2012-2015 to 30.1% in 2016-2019. Turkey's share in intra-regional exports also reduced from 39.4% to 29.5% over

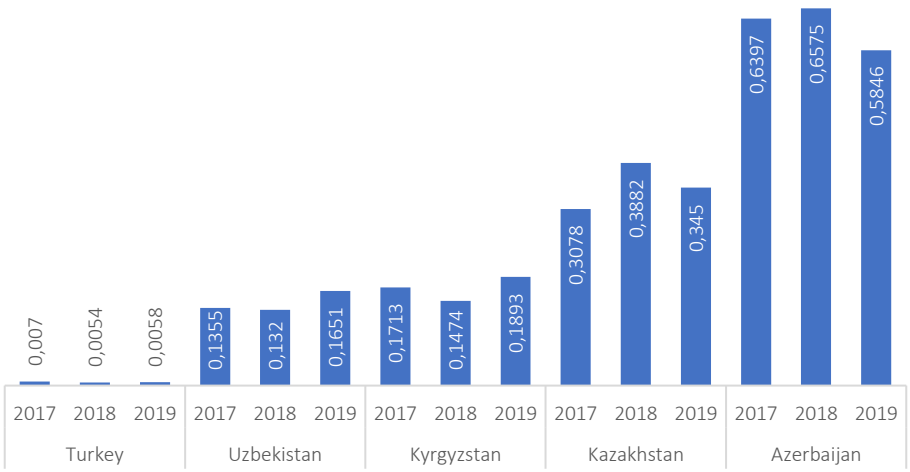
the same period. In contrast to Kazakhstan and Turkey, Uzbekistan's share in intra-regional exports has increased from 8.5% in 2012-2015 to 20.2% in 2016-2019, making it the third-largest export partner among the Member States (Figure 7.7). This significant increase is reflecting strong economic linkages between Uzbekistan and the other Member States.

Export Structure

There is a significant concentration of a few sectors in total exports of Uzbekistan to the world. According to UN Comtrade data, in 2019, around 55% of all its exports were gold-including gold plated with platinum (33%), petroleum gases and other gaseous hydrocarbons (15%), and cotton yarn (6%). This indicates a problem associated with export diversification and vulnerability to demand and price fluctuations.

Herfindahl-Hirschman Product Concentration Index (HHI) measures the dispersion of trade value across an exporter's products. A county with a preponderance of trade value concentrated in a very few products will have an index value close to 1. Thus, it is an indicator of the exporter's vulnerability to trade shocks. Measured over time, a fall in the index may indicate diversification in the exporter's trade profile. Figure 7.8 shows that Turkey most diversified economy among the Turkic Council Member States. Uzbekistan appears as the second least vulnerable Member State to trade shocks, although Uzbekistan's export value in 2019 was concentrated on fewer products, compared to 2018. Among the Member States, Azerbaijan's export values are most concentrated in very few products, indicating the highest vulnerability to trade shocks.

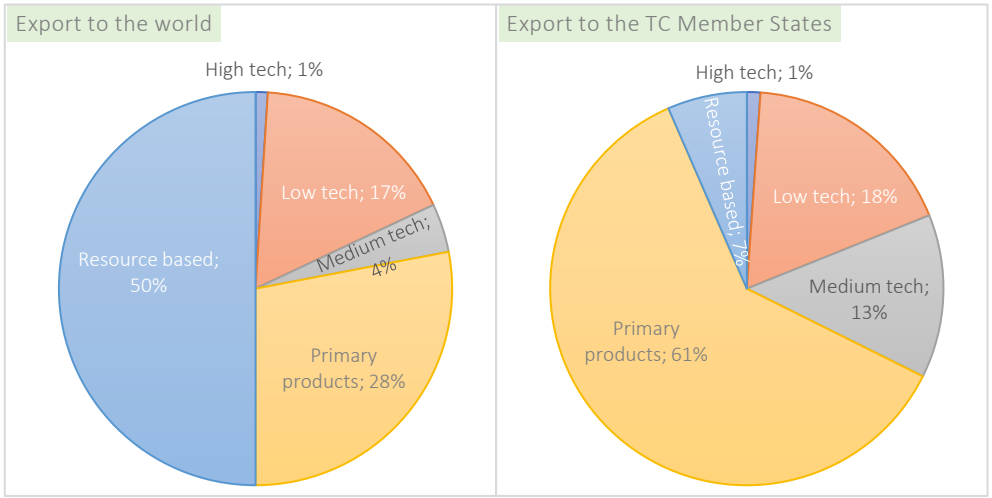
Figure 7.8: Herfindahl-Hirschman Product Concentration Index



Source: WITS - World Bank.
Note: Index takes values between 0 and 1. Export value concentrated in a very few products will have an index score close to 1. Thus, higher index score is an indicator of the exporter's vulnerability to trade shocks.

As can be followed from Figure 7.9 (left), in 2019, 50% of Uzbekistan's exports to the world were resource-based and 28% primary products. The share of low-tech products was 17%, while medium-tech products stood for 4% and high-tech products only 1%. This data shows that Uzbekistan is not among innovative economies. When it comes to exports to the Member States, in 2019, Uzbekistan managed to trade more technology-intensive products. 61% of its exports to the Member States were primary products, whereas low-tech products and medium-tech products' totalled 31%. Again, Uzbekistan's high-tech product share in the exports to the Member States was only 1% (Figure 7.9 right). Cooperation under Turkic Council's umbrella could facilitate knowledge sharing and technology transfer to create value chains and export higher value-added products.

Figure 7.9: Technological Classification of Uzbekistan's Exports (2019)

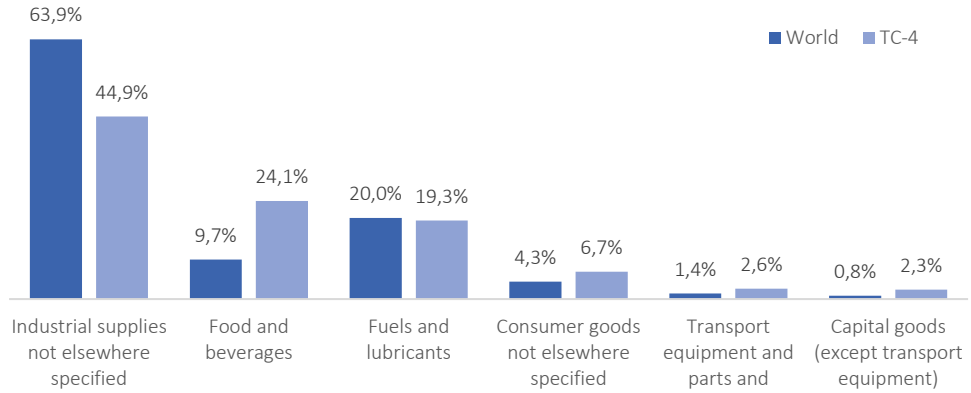


Source: WITS - World Bank based on UN Comtrade.

In terms of the distribution of export in broad economic categories, during 2017-2019, Uzbekistan, on average, exported mainly intermediate goods for further processing by other countries. Share of industrial supplies not elsewhere specified in total exports to the Member States accounted for 44.9%. Food and beverages (24.1%) and fuels and lubricants (19.3%) were the other essential categories of Uzbekistan's exports to the Member States. While the share of capital goods was meager (2.3% of the export to the Member States), exports of consumption goods not elsewhere specified constituted 6.7% of total exports to the other Member States (Figure 7.10).

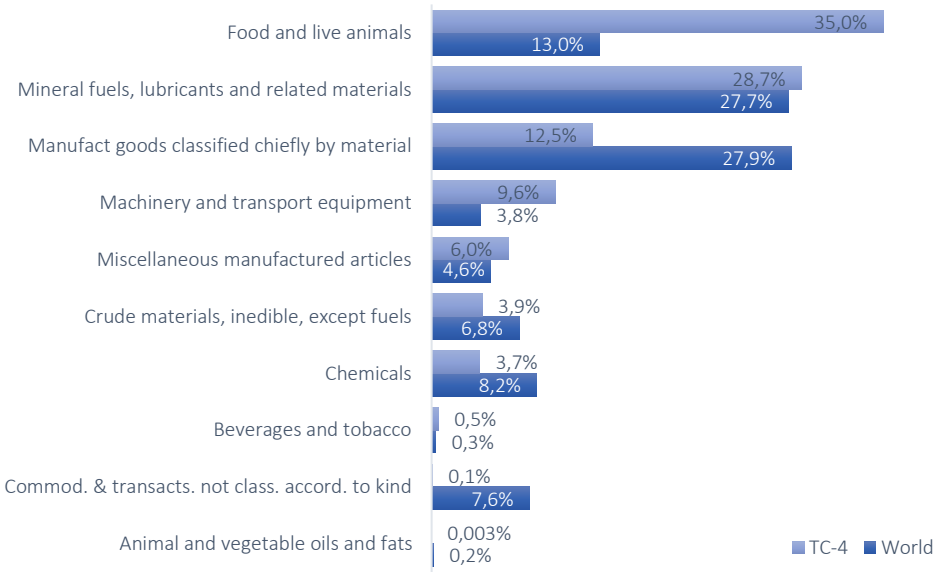
The average share of industrial supplies not elsewhere specified during 2017-2019 constituted 63.9% of Uzbekistan's total exports to the world. Fuels and lubricants (20%) constituted the second largest item of Uzbekistan's total exports, and fool and beverages (9.7) represented the third biggest category in Uzbekistan's overall exports to the world.

Figure 7.10: Distribution of Uzbekistan's Exports in Broad Economic Categories, (Average of 2017-2019, percent)



Source: WITS - World Bank based on Un Comtrade.
TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey.

Figure 7.11: Distribution of Uzbekistan's Exports by Sector (Average of 2017-2019, percent)



Source: WITS - World Bank based on Uncomtrade.
TC-4: Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey.

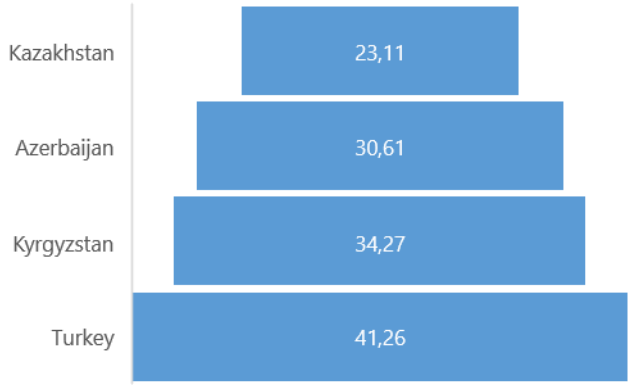
Grouping the export products classified under SITC 1-digit classification, Figure 7.10 presents Uzbekistan's average sectoral distribution to the world and Member States for 2017-2019. Uzbekistan's export to the world is comparably more diversified than its export to the TC-4. Driven by geographic proximity, Uzbekistan's export of food and live animals have a greater

concentration in the TC-4, with a share of 35% compared to 13% in export to the world. Uzbekistan's export of mineral fuels, lubricants and related materials is similar to both the world and the TC-4 countries, with an average value of near 28% in the same period. On the other hand, Uzbekistan's export of manufactured goods classified chiefly by material accounted for 28% of its exports globally, but this share was only 12.5% in its total exports to the TC-4 countries (Figure 7.11)

Trade Complementarity and Potentials

In strengthening economic and commercial partnerships, a standard indicator used is the trade complementarity index. This index measures the degree to which one country's export pattern matches the import pattern of another. A high degree of complementarity is assumed to indicate more favorable prospects for a successful trade arrangement. The index takes a value between 0 and 100, with zero indicating no overlap and 100 indicating a perfect match in the import/export pattern. Findings presented in Figure 7.11 indicate that in 2017-2019, on average, Uzbekistan had the highest trade complementary with Turkey, which means that they would significantly gain from the increased intra-regional trade. In the same period, Uzbekistan had the least trade complementarity with Kazakhstan. In the rest of the cases, the Uzbekistan export profile moderately complements the import profile of Azerbaijan and Kyrgyzstan.

Figure 7.12: Trade Complementarities of Uzbekistan with Turkic Council Member States (2017-2019 average)

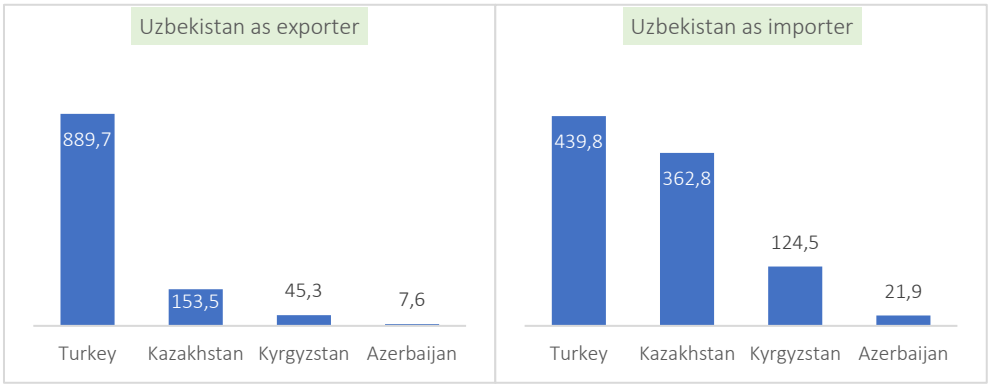


Source: WITS - World Bank based on Uncomtrade.
Note: The trade complementarity index indicates to what extent the export profile of the reporter country matches, or complements, the import profile of the partner country. A high index may indicate that two countries would stand to gain from increased trade

According to the International Trade Centre data, in 2019, there was a very limited untapped export potential between Uzbekistan and Azerbaijan. Yet, Uzbekistan could export $45.3 million more to Kyrgyzstan and import $124.5 million more. An even higher amount of export ($153.5 million) could be exported to Kazakhstan if measures are taken to tap on this potential. The highest untapped trade potential is reported to exist between Uzbekistan and Turkey. While Uzbekistan could export around $889.7 million more to Turkey in 2019, Turkey had a potential for additional export of $439.8 million to Uzbekistan (Figure 7.13). Overall, in 2019 Uzbekistan had a further export potential of $1.1 billion with Turkic Council Member States,

which requires measures to facilitate trade and tap on these opportunities to achieve greater economic integration.

Figure 7.13: Untapped Export Potentials of Uzbekistan (2019, million $US)



Source: Export Potential Map, International Trade Centre.

Trade Costs and Trade Facilitation

Uzbekistan's trade cost, which includes transport costs, tariffs, regulatory costs, and other costs incurred in getting goods to a final user, is highest with Azerbaijan, compared to the other Member States. From 2010 to 2018, on average, Uzbekistan's trade cost with Azerbaijan was estimated at 194% ad valorem, which means that an additional cost of near two times the original value of commodities was incurred their shipment from producers in Uzbekistan to customers in Azerbaijan. This cost at the same period was 123% for Kyrgyzstan and 120% for Turkey (Figure 7.14). The lowest trade costs are observed in Uzbekistan's trade with Kazakhstan (86%). Lower trade costs with Kazakhstan and Turkey allow tapping on the existing export potential between the countries. However, additional trade facilitation measures are also needed.

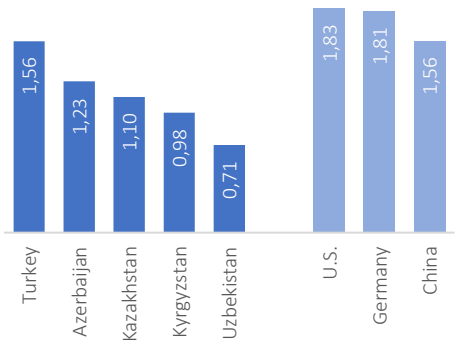
Figure 7.14: Average Trade Costs between Uzbekistan and other Member States (2010-2018 average)

Source: UNESCAP-World Bank Trade Costs database.

Trade facilitation refers to a specific set of measures that streamline and simplify the technical and legal procedures for products entering or leaving a country to be traded internationally. To help governments improve their border procedures, reduce trade costs, boost trade flows and reap greater benefits from international trade, the OECD has developed a set of Trade Facilitation Indicators (TFIs) that provide a basis for governments to prioritize trade facilitation

actions. TFIs are following the structure of the WTO Trade Facilitation Agreement. The TFIs take values from 0 to 2, where 2 designates the best performance that can be achieved.

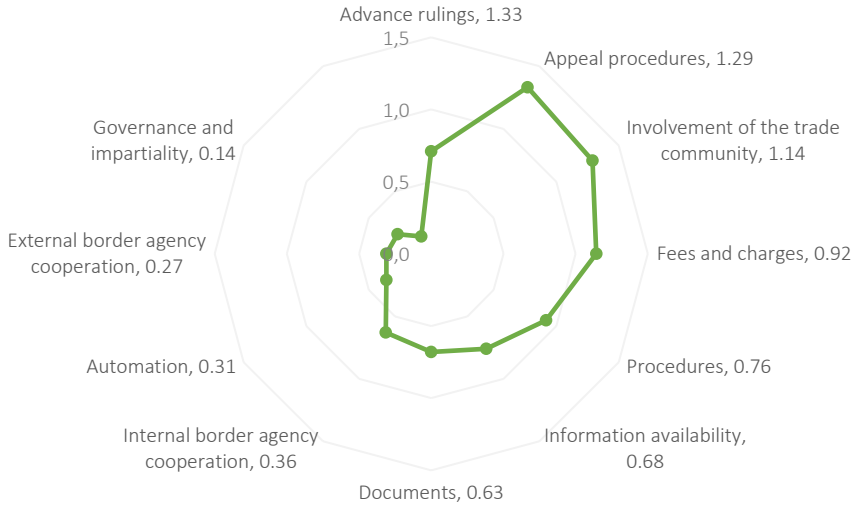
Figure 7.15: Average Trade Facilitation Performance (2019)



Source: OECD.

Figure 7.15 shows that Uzbekistan, with an average value of 0.71, performs relatively poorer than the other Member States in trade facilitation (Figure 7.15). Uzbekistan's most challenging areas are related to governance and impartiality, internal and external border agency cooperation, and automation, which are taking a score between 0.14 and 0.36 (see Figure 7.16). Fees and charges, procedures, information availability, and documents categories are also taking values below average in Uzbekistan. These indicators are also witnessing systemic failure and a critical bottleneck in the trade facilitation practices.

Figure 7.16: Trade Facilitation Indicators for Uzbekistan (2019)



Source: OECD.

7.2 Investment Flows

This section looks at the current trends in investment in Uzbekistan by analyzing selected FDI datasets and indicators. The section also provides some information on sectoral FDI trends to understand the level of concentration of multinational companies in Uzbekistan, which would help identify sectors with high growth and investment potential. The section's analysis would guide policymakers on attracting more investors into Uzbekistan, particularly from the Turkic Council Member States.

State of Investment in Uzbekistan

Developing countries generally suffer from insufficient domestic savings that limit the volume of investments made in an economy (UNCTAD, 2018). One of the effective ways to increase the level of investment in an economy is to benefit from foreigners' savings in the form of FDIs. As a developing Central Asian economy with more than 34 million population, Uzbekistan needs to attract and retain foreign investors to upgrade its infrastructure, bring new technologies, create jobs for the local labor force, and transfer knowledge for productivity growth. All these expected impacts from FDI would increase the competitiveness of the Uzbek economy and bolster trade volumes. Over time, this would translate into a higher level of wellbeing.

Since its independence, Uzbekistan has been mostly uninterested in foreign investments for a long time, making it the country with the least FDIs in Central Asia. In recent years, however, it has embarked on many major reforms to improve the investment climate for domestic and foreign investors. Today, improving the business environment to attract more FDIs is among the top priorities of Uzbekistan. On 25 December 2019, the President of Uzbekistan signed the Law on Investments and Investment Activities that introduce additional benefits to foreign investors. Foreigners can invest in a business venture in Uzbekistan in several ways, including by a) acquiring share in an existing company by participating in auctions or tenders organized under the privatization program; b) acquiring a stake in an existing company by direct negotiation with the owners of the shares or by purchasing shares on the stock market; c) forming a joint venture company with an Uzbek enterprise; d) establishing a new, wholly-owned company, or any other form that does not contradict Uzbek legislation. Uzbekistan does not restrict FDI in any sector, except for the sectors deemed to be related to national security.

The Foreign Investors Council is an advisory body under the President of the Republic of Uzbekistan. The Council is an institutional platform for direct dialogue between Uzbekistan and investors, including foreign companies, banks, international financial institutions operating in Uzbekistan, and other structures. The Council is coordinated by the Ministry of Investments and Foreign Trade, with the EBRD's assistance.

Investment Promotion Agency under the Ministry of Investments and Foreign Trade is Uzbekistan's designated state body responsible for coordinating policy aimed at attracting

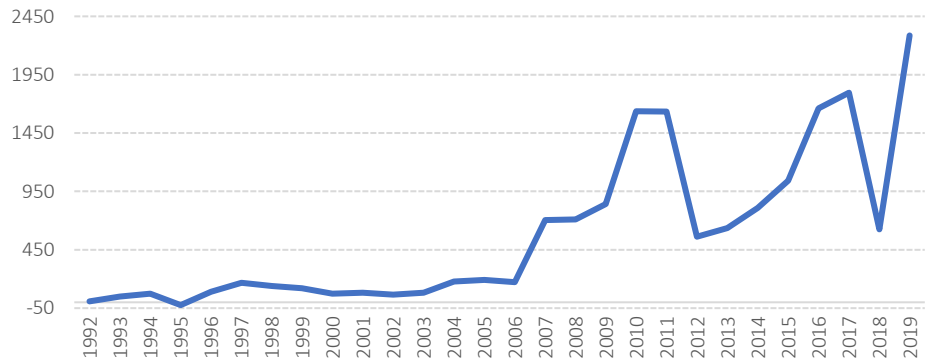
foreign investors. Moreover, the recently established Center for the Development of Investment Projects works on, among other things, identifying and developing new investment projects, implementing an interactive investment map of Uzbekistan, and providing technical support of investment projects.

At present, 22 free economic zones specialized for developing different economic sectors have been created and are functioning in Uzbekistan. Thanks to the benefits and preferences provided in Uzbekistan, the interest of foreign investors in free economic zones has increased significantly.

Uzbekistan has recently lowered taxes, reformed its foreign exchange regime, and introduced better protection to foreign investors' benefit. Due to all these reforms, Uzbekistan was named one of the top 20 "global improvers" in the World Bank's 2020 Doing Business report. Moreover, Uzbekistan was the "2019 Country of the Year" award winner by The Economist magazine.

Uzbekistan is a resource-rich country with a favorable geographic location that provides access to the largest regional markets. More than 2800 deposits and prospective manifestations of minerals have been identified in Uzbekistan, whose estimated value is $3.5 trillion. Uzbekistan occupies one of the world's leading places for many positions, including non-metallic and metallic minerals and agricultural raw materials. In particular, copper reserves put Uzbekistan at 11th place globally; in terms of gold production - 9th, uranium - 8th, and cotton fiber - 5th place. Uzbekistan's total energy reserves are sufficient to cover the national economy's needs for at least 100 years.

Figure 7.17: Inward FDI Flows to Uzbekistan (Million $US)

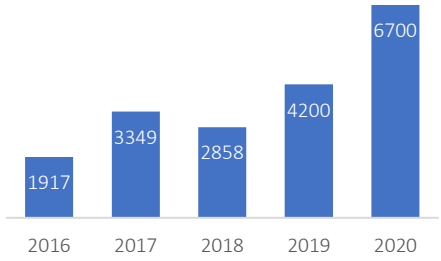


Source: UNCTAD database

Figure 7.17 shows that over the period 1992-2006, Uzbekistan stayed as a relatively closed economy to FDI. In that period, according to the UNCTAD database, the volume of FDI inflows to Uzbekistan has remained at symbolic levels. After 2006, the overall trend of FDI inflows became positive, although some fluctuations are observed. For example, the total value of FDI inflows to Uzbekistan went down from $1.6 billion in 2010 to $563 million in 2012. Later, the

2013-2017 period witnessed a sharp increase in FDIs inflows, whose value amounted historic high of $2.3 billion in 2019. As a result, Uzbekistan's share in the world inward FDI flows increased from 0.01% in 2006 to 0.15% in 2019, according to the UNCTAD data. However, official statics of Uzbekistan are reporting much higher inward FDI flows to the national economy. While UNCTAD data reports on inward FDI flows at $6.4 billion for the 2016-2019 period, data available at the Uzbekistan Investment Promotion Agency's web portal indicates to $12,3 billion FDI inflows for the same period (Figure 7.18). Obviously, there are significant methodological differences in counting FDI inflows between the universal dataset of UNCTAD and Uzbekistan's official data sources.

Figure 7.18: Alternative data on Inward FDI Flows to Uzbekistan (Million $US)

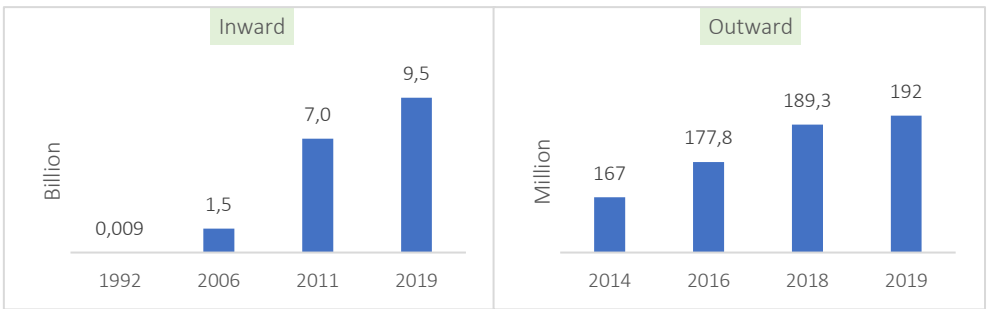


Source: Uzbekistan Investment Promotion Agency.

Furthermore, despite the harmful effects of Covid-19 on global markets, 2020 seems to be successful for Uzbekistan in attracting FDIs. According to the Uzbekistan Investment Promotion Agency, the country attracted $6.7 billion in FDI in 2020, including large investments in the electrical, chemical, and technology sectors. Thanks to the economic reforms that started in late 2016, Uzbekistan is expected to attract growing FDIs in the future (OECD, 2019a).

Figure 7.19 presents the FDI inward and outward stock figures of Uzbekistan, according to UNCTAD data. Uzbekistan's inward stock figure witnessed an impressive 85% increase in cumulative terms from 2006 to 2019. It went up from $1.5 billion in 2006 to 9,5 billion in 2019. This implies that foreign investors have increased their share in Uzbekistan's economy over time. Given the rapid growth recorded in the global FDI markets, FDI inward stocks of Uzbekistan constituted only a share of 0.026% in the world in 2019. Therefore, Uzbekistan needs to intensify its efforts to attract investors to reach its full potential.

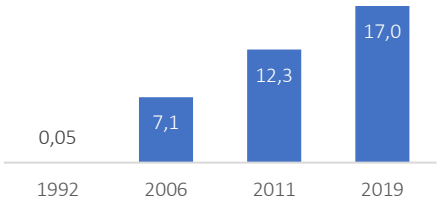
Figure 7.19: Inward and Outward FDI Stock of Uzbekistan (US$)



Source: UNCTAD database.

When it comes to Uzbekistan's outward FDI stock, according to UNCTAD data, it remained at a symbolic $192 million in 2019. In contrast to UNCTAD data, the IMF's Coordinated Direct Investment Survey reported above $1 billion of Uzbekistan's outward stock for 2019. Some of Uzbekistan's state-owned enterprises have invested in developing their marketing networks abroad to boost export sales. Similarly, some private companies that operate abroad primarily in the retail, construction, and textile sectors use outward investments for market outreach. According to the IMF data, countries that are hosting the most significant shares of Uzbekistan outward investments are Russia, Latvia, UK, Azerbaijan, South Korea, and Kazakhstan.

Figure 7.20: Inward FDI Stock of Uzbekistan as Percentage of GDP

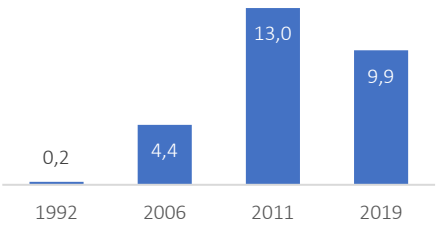


Source: UNCTAD database.

Compared to the world average of 41.8% per capita FDI inward stock, Uzbekistan seemed to still stay insufficient with a per capita FDI stock value of 17% in 2019. Compared to other Member States (Chapter 5, Figure 5.3), Uzbekistan's per capita FDI inward stock remains significantly lower. Nevertheless, the progress achieved since 2006 is outstanding that the per capita FDI inward stock became 2.4 times higher (Figure 7.20).

According to Figure 7.21, FDI inflows made a relatively significant contribution (13%) to the gross fixed capital formation (GFCF) in Uzbekistan in 2011. Nevertheless, in 2019 this share was measured at 9.9% and remained well below the same values recorded for Azerbaijan, Kazakhstan, and Kyrgyzstan (Chapter 5, Figure 5.4). In this context, Uzbekistan needs to exert its efforts to attract more FDI and gain a higher share in the world investment map. Also, efforts should be made to increase the contribution of FDI to the GFCF.

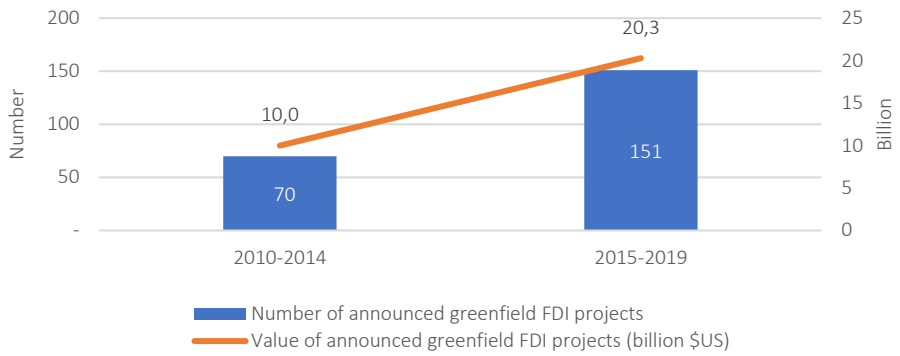
Figure 7.21: FDI Inflows in Uzbekistan as Percentage of Gross Fixed Capital Formation



Source: UNCTAD and Word Bank database.

Greenfield investment figures can bring additional insights as they are usually recognized as a more beneficial entry form of investment. According to Figure 7.22, the total number of announced greenfield FDI projects increased by 81 compared to the 2010-2014 period and reached 151 over 2015-2019. The total value of announced greenfield FDI projects was measured at $10 billion in 2011-2014. The value of these FDI projects exceeded $20,3 billion between 2015 and 2019. In short, both in terms of the number and value of greenfield FDI projects, Uzbekistan followed a positive pattern by providing a conducive investment environment for investors over the recent years. In particular, special economic zones have played a catalyst role in Uzbekistan to attract FDI.

Figure 7.22: Greenfield FDI Projects in Uzbekistan (Cumulative)



Source: UNCTAD database.

The increasing competition among countries at the global level to host more FDI should not discourage Uzbekistan in this journey. Instead, Uzbekistan needs to accelerate recent reforms and widen its scope to be inclusive of all sectors. In this picture, it is proposed for Uzbekistan to continue with the privatization of state-owned enterprises (SOEs) or remove restrictions on sectors that SOEs are active to allow for competition. In fact, Uzbekistan made strides towards this direction in specific sectors. For example, state-owned hotels now compete with privately-owned hotels in Uzbekistan. Uzbekistan even provides certain targeted incentives to attract international investors into the hotel and hospitality sector to increase bed capacity and improve service quality. On the other hand, full shares of 62 SOEs have been sold as of November 2020.

Investment in Uzbekistan by Sectors

The prioritization and identification of investment projects in various sectors is a daunting task. Uzbekistan is trying to attract FDIs into the different economic sectors by offering tax benefits to particular industries, including electronics, tourism, ICT, textiles, food, building materials, chemicals, and pharmaceuticals. However, investors look for sectors where there is high profitability and opportunity to sustain growth and revenues. In this regard, Table 7.1 ranks the top-10 sectors with greenfield FDI projects in Uzbekistan over the period 2003-2017. The coal, oil and natural gas sector is ranked first and followed by chemicals, plastics, and communications sectors. Almost 50% of Uzbekistan's FDI benefits the coal, oil and natural gas industries. Building and construction materials, textiles, financial services, transportation, metals, and automotive sectors are also listed in the top-10 popular sectors for foreign investors in Uzbekistan.

As shown in Figure 7.23, with 48%, the energy sector of Uzbekistan has remained as most attractive for FDI inflows within the first three quarters of 2020. Textile industry (18%) and automobile sector (14%) have also increased their significance for foreign investors. Chemistry and education sectors have in total counted for 8% of FDI inflows in the same period. The

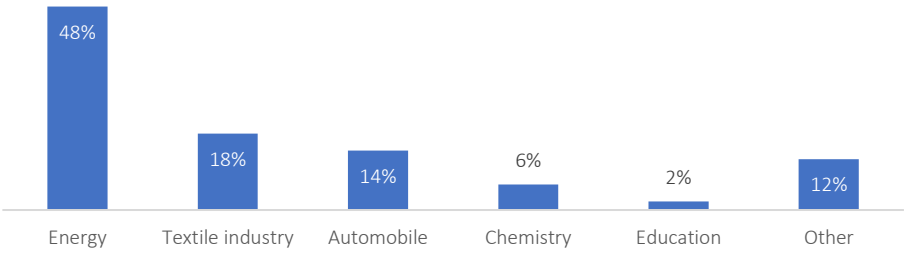
sectors listed in Table 7.1 and Figure 7.23 provide a broad idea about the attractiveness of various Uzbekistan sectors that could motivate potential investors, particularly from other Turkic Council Member States.

Table 7.1: Top-10 Sectors with Greenfield FDI in Uzbekistan (2003-2017, ranking based on cumulated value)

1	Coal, oil and natural gas	6	Textiles
2	Chemicals	7	Financial Services
3	Plastics	8	Transportation
4	Communications	9	Metals
5	Building and Construction Mat.	10	Automotive

Source: OECD and FDI Market (2019).

Figure 7.23: FDI Inflows in Uzbekistan by Industries (First three quarters of 2020)



Source: Uzbekistan Investment Promotion Agency.

Investment in Uzbekistan by Source Country

According to the State Committee of the Republic of Uzbekistan on Statistics, 11,781 companies with foreign capital were operating in Uzbekistan as of January 2021. From January 2017 to January 2021, the number of foreign affiliates registered in Uzbekistan has increased by near 6,800 (Figure 7.24). Approximately 3,000 of them were created in 2019. The rapid increase of companies with foreign capital testifies Uzbekistan's rise as a new investment destination in Central Asia.

Figure 7.24: Number of Companies with Foreign Investments in Uzbekistan

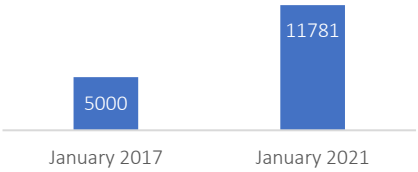
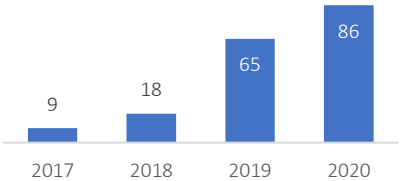


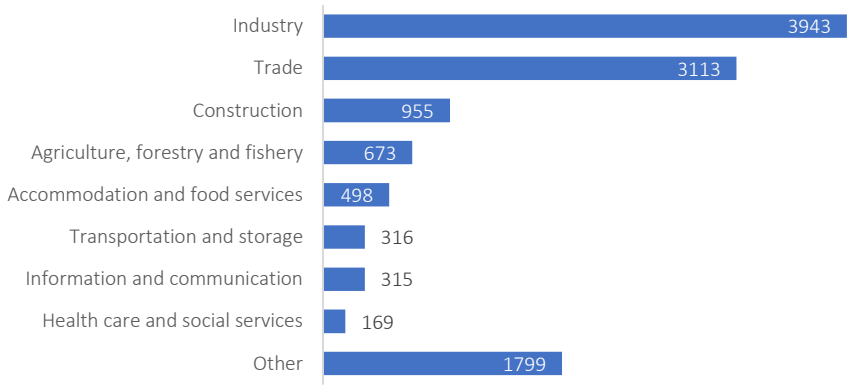
Figure 7.25: Number of Countries with Visa-Free Entry to Uzbekistan



Source: Uzbekistan Investment Promotion Agency and State Committee of the Republic of Uzbekistan on Statistics.

It should be underlined that the number of countries with visa-free entry to Uzbekistan has increase from 9 in 2017 to 86 in 2020 (Figure 7.25). Most of the EU and CIS countries, China, Japan, South Korea, UAE, and many other countries, are subject to the visa-free regime in Uzbekistan. Moreover, Uzbekistan has introduced a simplified visa regime for citizens of 57 other countries.

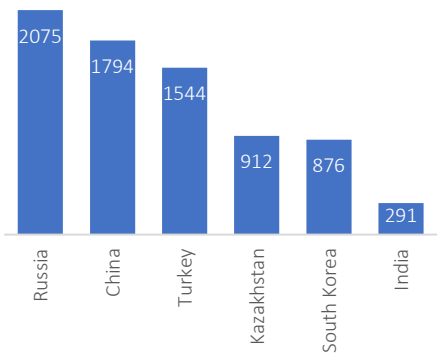
Figure 7.26: Distribution of Companies with Foreign Investments in Uzbekistan by Sectors (January 2021)



Source: State Committee of the Republic of Uzbekistan on Statistics.

Out of the total number of registered companies with foreign capital (11,781), 5,672 were joint ventures and 6,109 foreign companies as of January 2021. Most of the companies with foreign capital were operating in the industry (3,943), trade (3,113), construction (955), and agriculture, forestry and fishery (673) (Figure 7.26).

Figure 7.27: Countries with the Largest Number of Companies in Uzbekistan (As of December 2020)



Source: State Committee of the Republic of Uzbekistan on Statistics.

As of December 2020, most of the foreign companies operating in Uzbekistan belong to Russia (2,075), China (1,794), Turkey (1,544), Kazakhstan (912), South Korea (876), and India (291). Companies from these five countries represent almost 65% of all registered companies in Uzbekistan with foreign capital.

According to the World Investment Report 2020, one part of FDI inflows to Uzbekistan in 2019 was related to the ongoing large oil and gas projects by Lukoil, Russia. Further, some projects have started in chemical production, with Chinese, Russian, Singaporean, UK, and US firms. Orano Mining firm of France has invested in uranium exploration and

development, whereas Chinese, German, Indian, Korean, Thai, and Turkish companies have started projects in the textiles and apparel industry.

According to the Bank of Russia data, from 2007 until the second quarter of 2020, net outward flows to Uzbekistan accounted for $1,2 billion. However, as of August 2019, the cumulative volume of Russian investments in Uzbekistan amounted to near $9 billion, according to Uzbekistan's Embassy in Russia. It is estimated that close to 2.2 million Uzbek labor migrants work in Russia. Uzbekistan received the status observer in the Eurasian Economic Union on 11 December 2020. Further expansion of Russian investments in Uzbekistan's economy is expected in the future.

Together with the rapprochement to Eurasian Economic Union, Uzbekistan remains committed to the China-led Shanghai Cooperation Organisation (SCO). As of early 2018, China's aggregate investments in Uzbekistan reached $8 billion, according to the IHM Markit. It is expected from China to contribute to infrastructure improvement and diversification of Uzbekistan's economy. Chinese companies in Uzbekistan are involved in industry and trade, construction, oil and gas exploration, transport, infrastructure building, telecommunications, textiles, chemicals, and logistics, and agriculture.

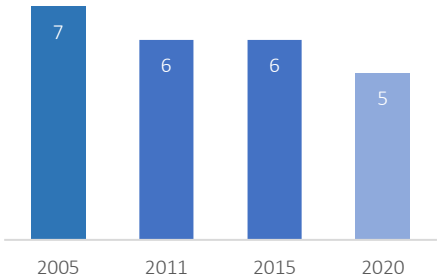
According to the Central Bank of Turkey, in 2019, Turkey's outward FDI stock in Uzbekistan amounted to $198 million. However, the Ministry of Foreign Affairs of the Republic of Turkey estimates nearly 1 billion Turkish FDIs in Uzbekistan. In 2020, 305 Turkish enterprises launched the business in Uzbekistan. Turkish company Cengiz Enerji announced an FDI of $150 million in building a thermal power plant in Uzbekistan. Still, the existing figures imply limited investment directed to Uzbekistan from the Turkic Council Member States. However, with Uzbekistan's membership in the Turkic Council and intensified economic cooperation among the Member States, Uzbekistan will likely host more investors from the Turkic Council countries in upcoming years.

Improving Investment Climate

Uzbekistan's economic integration in terms of FDI with the other Member States is quite limited. There is significant untapped potential that needs to be addressed by designing and implementing effective policies at the national and regional levels. Improvement of the investment climate at the national level is very critical. The new reform agenda and strong leadership have helped Uzbekistan attract more investment recently from abroad. Uzbekistan reforms were acknowledged by the international community and organizations (EBRD, 2019).

Nevertheless, Uzbekistan still has a long way to establish a more conducive investment environment, particularly for businesses and investors. The OECD country risk classification score could give an idea on this point (Figure 7.28). Uzbekistan's score decreased from 7 (the highest risk score possible) in 2005 to 5 in 2021 (a relatively modest risk score). Azerbaijan, Kazakhstan, and Turkey also obtained 5 in 2021, but Kyrgyzstan had a score of 7. A higher risk score reflects that a country still has some risks such as on transfer and convertibility of profits

Figure 7.28: OECD Risk Classification for Uzbekistan

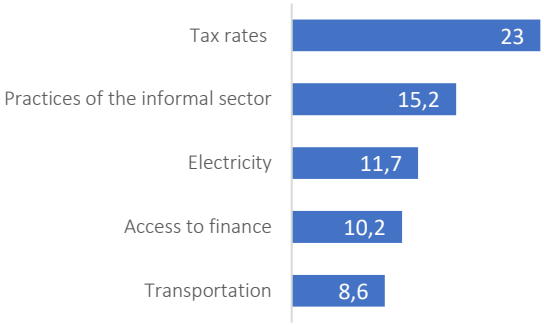


Source: OECD Country Risk Classification Dataset, Version: 29/01/2021. Risk score scale: 0 (lowest risk)- 7 (highest risk).

of multinational companies and cases of force majeure (e.g., war, expropriation, civil disturbance, floods, and earthquakes). In this respect, Uzbekistan is on the right track to eliminate its risk exposure and uncertainties for investors. Nevertheless, the country risk score of 5 is still high for many international investors. Therefore, Uzbekistan and the other Member States require to take additional measures to down it.

To identify priority areas in the reform process to improve Uzbekistan's investment climate, some firm-level data would be illuminating for policymakers. According to the World Bank Enterprise Survey, 23% of Uzbekistan firms indicated that tax rates constituted the biggest obstacle for their business in 2019. The existence of informal sector practices was mentioned as the most significant obstacle by 15.2% of companies. Problems regarding electricity infrastructure (11.7%), access to finance (10.2%), and transportation (8.6%) were also on the list of top-five major obstacles for firms in 2019 (Figure 7.29). This exclusive list provides some evidence on significant barriers and areas of concern to be focused on to improve the investment and business climate in Uzbekistan. Without an improved business and investment climate, it will be difficult to unleash the Turkic Council Member States' potential investments. Therefore, Uzbekistan should eliminate remaining investment and trade barriers, reduce country risks, and improve infrastructure and competitiveness to attract more FDI from the other Member States and beyond.

Figure 7.29: Top Five Biggest Obstacles to Doing Business in Uzbekistan (2019)



Source: World Bank, Enterprise Survey.
Note: 1239 firms from Uzbekistan took place in the survey.

CHAPTER

VIII

Policy Issues for Creating and Maintaining a Strong Economic Cooperation

8 Policy Issues for Creating and Maintaining a Strong Economic Cooperation

Economies across the world plunged into deep contractions as the Covid-19 pandemic-imposed lockdowns across the globe. Even countries among the 20 largest economies experienced negative growth in their GDPs in 2020. Even before the outbreak of the Covid-19 pandemic, the economies of some Turkic Council Member States were already slowing down. Later, the oil and gas reach Member States' GDP growth started to face a double shock from collapsed external demand for hydrocarbon exports and historically low crude oil prices.

In general, in the fight against the Covid-19, Member States have introduced expansionary fiscal policies and stimulus packages in 2020 that have affected the budget deficit. On the other hand, deep falls in the domestic demand due to containment measures, weak external sector performance, the loss of labor remittance inflows, and low investment have negatively affected economic growth. In general, business confidence took a significant hit in 2020, industry run below full capacity, labor markets have weakened, and citizens' welfare is negatively affected, owing to lost jobs and upward movements in the prices of primary articles (mainly food).

Despite the negative impact of the Covid-19 pandemic on the economy, among Turkic Council Member States, only Turkey and Uzbekistan managed to avoid entering a recession, with the real GDP growth of 1.8% and 1.6% in 2020, respectively. Along with a resilient manufacturing sector, the construction boom was a crucial factor enabling Uzbekistan to achieve a positive economic growth rate in 2020. In contrast, the National Statistical Committee of the Kyrgyz Republic announced that countries' real GDP contracted by 8.6% in 2020.

Major forecasting institutions such as the World Bank, IMF, and the Economist Intelligence Unit (EIU) predicts that the number of countries with negative growth rates will significantly drop worldwide in 2021. However, in general, real GDP is not expected to return to pre-crisis levels before 2022. However, according to the EIU, given the Turkic Council Member States' considerable catch-up potential and strong trade links with big markets such as China (which did not experience a recession in 2020) and Russia, their real economic output may reach the 2019 peak by the end of 2021.

As most Covid-19 related restrictions are lifted from the second quarter of 2021, consumer spending is expected to accelerate. The GDP growth is also likely to be driven by the services and external sector as the global economy recovers. A partial recovery of global oil prices will also help oil and gas reach Member States' economies to return to growth in 2021. Government spending will also support domestic demand.

Still, the rate of global and Member States' economic recovery relies heavily on the course of the Covid-19 pandemic. Controlling Covid-19 is essential to restoring the economy, and failures in vaccine deployment could delay this process. However, the vaccines will not be

available in sufficient quantities in a short time to allow the immunization of entire populations. The good news is that among the Turkic Council Member States, Turkey and Kazakhstan are developing their own vaccines. Moreover, In December 2020, Kazakhstan started producing the Russian-developed Sputnik V coronavirus vaccine domestically. Keeping in mind Member States' strong solidarity and cooperation in the fight against the pandemic so far, Turkey and Kazakhstan's vaccines will surely fasten vaccine deployment in all Member States.

As Member States step into an economic recovery phase with the vaccines' rollout against Covid-19, they need to boost longer-term investments that enable more sustainable and resilient development by supporting the transformation toward a smarter, digital and greener economy. Policies for the next generation, including education and skills, should also be included. Moreover, most Member States need to diversify their economies to reduce the high risk of volatility in commodity markets and fluctuations in global energy demand. Cooperation under the Turkic Council's umbrella could provide additional impetus in enforcing economies by undertaking actions at the regional level, as proposed below.

8.1 Improving Transportation Networks and Connectivity

Global trade and investment patterns have been changing over the last decades. The importance of Asia in world merchandise exports has been on the rise. Global manufacturing is increasingly taking place in Asian economies, improving their productivity and competitiveness globally. When it comes to the Turkic Council Member States (TC MSs), some severe obstacles prevent their effective participation in regional and global value chains. While some are landlocked with no direct access to seaports, some others are economically too small to be part of global value chains. The lack of connectivity diminishes their prospects for reaching global markets and export at competitive prices, which further deteriorates their level of economic integration and competitiveness.

In this connection, the TC MSs must improve transport connectivity to enable people and firms to reach regional and international markets, thereby contributing to greater trade volumes, investment flows, and more robust value chains. Higher reliability of trans-shipments and better predictability of supply chain operations in transport connectivity would facilitate firms' integration into regional and international value chains and foster their productivity and competitiveness. When complemented with soft measures, such as harmonizing transport regulations and cooperation of border agencies, better connectivity would reduce trade costs and increase trade. Therefore, while it is crucial to develop, maintain and upgrade transport infrastructure networks, it is also paramount to cooperate in aligning rules and regulations about the cross-border transportation of goods.

Several recommendations have been proposed to improve transport connectivity and facilitate regional economic integration. While these recommendations are essential in improving transport infrastructure, financial feasibility, political stability, and adequate institutional arrangements should be part of the overall agenda for encouraging deepening economic relations.

Strengthen Cooperation on the Realization of Trans-Caspian International Transport Corridor

Trans-Caspian International Transport Corridor, also known as the Middle Corridor, is one of the most critical regional transport projects to improve connectivity in the region. Initiated by Turkey, the corridor passes by rail and road through Georgia, Azerbaijan, and the Caspian Sea. It reaches China by following Kazakhstan or Turkmenistan-Uzbekistan-Kyrgyzstan route. Ports of Baku/Alat (in Azerbaijan), Aktau/Kuryk (in Kazakhstan), and Turkmenbashi are the main points of multimodal transport on the Caspian transit corridor. The Middle Corridor is argued to be more economical and faster than the Northern Corridor (the Trans-Siberian Railway) as a trade route between Europe and Asia. Furthermore, the Middle Corridor offers excellent opportunities for the cargo traffic in Asia to reach Middle East, North Africa, and the Mediterranean region by benefiting from Turkey's port connections.

In recent years, significant steps have been taken by Turkic Council countries to improve the infrastructure capacity and transit potential of the Middle Corridor. Logistical expenses went down due to decreases in the costs of transit passages and Caspian crossings in Azerbaijan. The customs procedures in Aktau Port have been streamlined due to the single window system, and port charges were reduced, making the transport operations faster and cheaper. The operationalization of the Kyrk Port has also contributed to the transit potential of the Middle Corridor. Baku-Tbilisi-Kars railway was opened in 2017. Marmaray Rail Tunnel, Yavuz Sultan Selim Bridge, and Eurasia Road Tunnel -three big projects bridging Asia and Europe over and under Bosporus in Istanbul- were operationalized. Bishkek-Naryn-Torugart Road was rehabilitated, and the China-Kyrgyzstan-Uzbekistan railway project is going on.

Further, several new transportation corridors traversing the Caspian Sea, such as the Lapis-Lazuli Corridor, have increased the Middle Corridor's feasibility and extended its connectivity to other regions, including complementarity to China's Silk Road Economic Belt initiative. In addition to already done improvements, the countries along the Middle Corridor need to find ways for better operational and legislative harmonization in transport and customs, facilitating the administrative procedures, and strengthening relations among their transport and customs bureaucracies as well as logistics sectors.

To further increase the efficiency and competitiveness of the Middle Corridor, the Turkic Council countries are recommended to (1) take steps for the privatization of the Caspian ports and shipping services, which will enhance physical infrastructural preparedness and operational quality, as well as decrease costs and facilitate shipments through competition. Privatization at the Caspian ports and shipping services will lead to, among other things, a) increasing the number of Ro-Ro and train-ferries and cargo capacities as well as establish regular services; b) making prices more suitable for the Caspian Sea passes; c) facilitating the planning of the transport activities by introducing Automatic Ticket Sale System, and d) decreasing the port charges and enhance the quality of the ports. In order to render the Middle Corridor a viable complementary option in the east-west trade, TC MSs are also recommended to (2) liberalize the transit passes, (3) facilitate the administrative procedures, and (4) improve and enlarge the implementation of the existing Sister Ports Agreements. Yet, there is a need for dedicated long-term efforts to improve the hard infrastructure necessary to support the efficient transportation and transit of trade shipments.

Make Use of Other Corridor Investments under DRC of CAREC/ADB and BRI of China

The Asian Development Bank also develops some designated rail corridors (DRCs) under its CAREC program that contribute to improving transport connectivity across the TC MSs. Particularly, DRC-2 of CAREC connects China and Turkey via Central Asia with three alternative routes connecting the TC MSs.[3] As a multimodal corridor with some missing links, it is currently not heavily used for rail freight traffic but has significant potential in promoting connectivity. In this connection, the TC MSs can more actively engage in the activation of this corridor. They can incorporate the components of this project into the national development strategies and programs. Thereby, they can also benefit from the great potential of growing transit trade.

There are also a growing number of initiatives undertaken within the Chinese Belt and Road Initiative (BRI). The China-Central Asia-West Asia Economic Corridor has the most significant potential in facilitating trade and investment within the region. Intra-regional partnership and cooperation with China and multilateral organizations could accelerate the realization of the investment projects along these corridors and improve regional connectivity.

Invest in Railway Networks and Enhance Their Interoperability

Railways allow moving freight traffic at a low cost and with a small environmental footprint. Investments in rail networks contribute to the expansion of trade, particularly in landlocked countries. Infrastructure gaps and missing links along rail and road networks should be identified and filled cost-effectively. While investments in rail networks should be expanded to increase connectivity within the region, the implementation of related soft measures to facilitate trade would make railways attractive for shippers and transport operators.

Moreover, efficient international transport networks through railways depend on a high level of interoperability among the railways. Considering the different rail gauges across the region, standards of interchange facility design, efficient load transfers, and operational coordination of equipment and facilities are particularly important. In this regard, given the challenge in achieving technical interoperability, TC MSs should aim to harmonize the regulatory framework to facilitate cross-recognition of rolling stock, streamline border crossing procedures and implement uniform commercial and legal framework to boost international traffic.

Nonetheless, it is essential to support multimodal solutions to ensure that all transport modes are working together seamlessly. Road-rail solutions are most important for landlocked countries in the region; but, access to foreign ports through the Caspian Sea or the Black Sea and the Mediterranean Sea via Turkey can also be a solution. To achieve an effective

[3] These routes are **DRC 201:** Hami (PRC)–Urumqi (PRC)–Alashankou (PRC)–Dostyk (KAZ)– Mointy (KAZ)–Zharyk (KAZ)–Saksaulskaya (KAZ)–Shalkar (KAZ)–Beyneu (KAZ)–Aktau (KAZ)–(Caspian Sea)–Alyat (AZE)–Baku (AZE)–Beyuk Kesik (AZE)–Gardabani (GEO)–Tbilisi (GEO)–Kars (TUR); **DRC 202:** Hami (PRC)–Kashi (PRC)–Torugart (KGZ)–Savai (KGZ)–Karasuu (UZB)–Andijan (UZB)–Pap (UZB)–Tashkent (UZB)–Djizzak (UZB)–Samarkand (UZB)–Navoi (UZB)-Karakalpakiya (UZB)–Oasis (KAZ)–Beyneu (KAZ)– Aktau (KAZ)-(Caspian Sea)-Alyat (AZE)–Baku (AZE)–Beyuk Kesik (AZE)–Gardabani (GEO)–Tbilisi (GEO)–Kars (TUR); and **DRC 203:** Hami (PRC)–Kashi (PRC)–Torugart (KGZ)–Savai (KGZ)– Karasuu (UZB)–Andijan (UZB)–Pap (UZB)–Tashkent (UZB)–Djizzak (UZB)–Samarkand (UZB)–Navoi (UZB)–Bukhara (UZB)–Khodzhidavlet (UZB)–Farap (TKM)–Turkmenabat (TKM)–Mary (TKM)–Ashghabat (TKM)–Turkmenbashi (TKM)–(Caspian Sea)–Alyat (AZE)–Baku (AZE)– Beyuk Kesik (AZE)–Gardabani (GEO)–Tbilisi (GEO)–Kars (TUR)

multimodal transport network, infrastructure, and regulatory bottlenecks should be identified and effectively handled.

Adopt Innovative Financing Mechanisms for Infrastructure Development

Investments in transport infrastructure require a significant amount of resources. The lack of adequate resources and limited conviction on the economic viability of the large transport investments connecting the Member States slows down the implementation of projects that would increase regional integration. In most cases, the public sector as the primary funding source faces significant constraints to allocate enough resources. This is likely to worsen in the current economic environment due to the pandemic. Lack of resources earmarked for maintaining existing transport networks may also disrupt these corridors' efficient functioning.

In this regard, it is critical to find alternative financing mechanisms for infrastructure development. Multilateral development banks play a paramount role in financing major transport investment projects. However, there is a need for more private sector participation. The experience of Turkey is particularly exemplary. Since 2005, Turkey realized transport investments that exceed $ 70 billion with the private sector's involvement. This amount is only around $ 1 billion in Kazakhstan and $ 25 million in Uzbekistan.

Support Economic Activities along the Transport Corridors

In order to benefit from investments in transport corridors, it is necessary to promote the organization of economic activities along the corridors to establish economic clusters, create jobs, increase productivity, and foster economic development. Corridors provide essential opportunities to increase the diversity and density of economic activities in affected regions. Yet, such measures should be taken in a way that is not in conflict with the transit objectives of greater speed and reliability in carrying goods.

It is also necessary to enhance local connectivity along with international transport and transit corridors. Transit corridors initiated around the region are focused on point-to-point transportation, with little role for anything in between. International programs' main corridors need to be complemented by national and intra-regional connectivity measures to ensure connectivity within the country and the region.

Support the Logistics Sector and Establish Logistics Terminals

A strong and modernized logistics sector is inevitable for the effective use of transport networks. The development of the logistics sector should be supported through various incentives, such as professional training and higher education in logistics and transport, and the involvement of the private sector in devising national logistics policies. Barriers to market entry should be minimized to attract leading international firms operating in the sector. Operators of both the rail and road freight sectors could enhance their productivity if adequate improvements are made in these sectors' regulations.

An important instrument to improve efficiency and productivity is establishing logistics terminals. At border crossings, particularly at gauge change locations, establishing high volume

bulk distribution and logistics terminals to consolidate bulk commodities, such as petroleum products, chemicals, cement, and wheat, could provide cost and operational efficiency advantages. Before establishing such terminals, there is a need to develop economic feasibility studies, operation procedures, and ownership structure.

Strengthen Transport Facilitation Measures and Harmonise Freight-Related Standards

Effective transport connectivity requires developing regional agreements to formalize the regional rail, road, and dry ports networks as parts of an integrated network. However, the lack of coordination and harmonization of freight-related rules and standards remains one reason for lower trade flows and economic integration. This requires strengthening transport facilitation measures, including harmonization of transport technical and operational standards, regulations, and practices; understanding and use of new technologies; and implementation of transport facilitation tools and frameworks. It is vital to ensure that bilateral and multilateral agreements are implemented and enforced, particularly in standardizing the regulations on entering and crossing each country and on the maximum weight and axle loads of heavy goods vehicles. In the presence of contradictory bilateral agreements, efforts should be made to either bring the bilateral agreements in compliance with each other or sign multilateral agreements.

Standards should also be harmonized in data collection and sharing as well as in administrative procedures related to road and rail transport. Sharing long-term railway and road traffic forecasts for corridors would improve policy needs for better connectivity. Finally, the member countries may consider establishing supervisory bodies and adopting conforming mechanisms to ensure the implementation and application of the bilateral and multilateral agreements and related guarantees.

8.2 Encouraging Economic Diversification, Industrialization and Value Chain

Economies of some TC MSs depend on producing a limited set of products, reflecting the concentration of economic activities in few sectors. It is often argued that dependence on natural resource and primary goods-based exports is not conducive to development. They are not only inapt to technological progress but also vulnerable to terms of trade shocks. Excessive dependence on a few sectors or natural resource-based products raises the risks and vulnerabilities associated with a narrow economic base. Diversification into multiple sectors and products, on the other hand, reduces these risks and vulnerabilities and expands the opportunities for higher competitiveness in global markets with a greater capacity to achieve long-run sustained growth. Product diversification can also help diversify the customer base and reduce the reliance on a narrow range of importers.

Economic development requires transforming a country's economic structure from low productive sectors to high productive sectors. Higher-quality varieties of existing products help to build on existing comparative advantages to boost productivity and export revenues. The sophistication of production processes also facilitates value chains and economic integration. In this connection, several policy recommendations are made to encourage economic diversification, industrialization, and value chain within the region. This section

provides some suggestions on how to achieve more economic resilience through economic diversification and regional integration.

Design Specific Policies to Support Economic Diversification

Economic development relying on few sectors creates excessive macroeconomic volatility and vulnerability in the development process. This requires a structural transformation in economies by reallocating productive resources in more promising sectors. Structural transformation is a continuous process and occurs along with economic diversification. It involves extensive changes with new sectors emerging and overall infrastructure improving. Technological developments facilitate the upgrading and diversifying the production base with more sophisticated production processes and products.

A well-diversified economy requires a sophisticated and robust manufacturing industry to enhance and retain its competitiveness in the global economy. The lack of competitiveness is also associated with poor economic diversification in industrial activities. Therefore, TC MSs need to devise effective policies to achieve economic diversification and strengthen their economic resilience. This could be done by promoting entrepreneurship, industrialization, human capital accumulation, and innovation. By creating linkages and value chains outside the traditional sectors, greater regional integration also increases economic diversification and productivity.

Provide Targeted Incentives to Promote Industrialization

An essential step in achieving economic diversification and industrial development is a well-designed industrial policy. While designing the policy, it is critical to understand the issues behind the successful and failed experiences of previous industrialization attempts, identifying sectors and industries where individual countries can invest with existing resources, capacities, and prevailing multilateral agreements and other external conditions. It is also important to utilize other economic policy instruments to complement and support the industrial development process.

Economic development is a dynamic process, which requires governments to play a proactive and facilitating role in achieving structural transformation. It is essential to identify the potential areas where countries can be productive and competitive with the right investments in capacities and interventions. They must intervene to allow markets to function properly by providing information about new industries in which achieving productivity growth and competitiveness are attainable with the country's existing resources and capabilities.

In this connection, policymakers in the region should identify the right industries, remove the binding constraints they face, and provide appropriate incentives for them to grow. Such policies aim to attain structural transformation by targeting specific sectors, technologies, or tasks. In addition to policies that favor particular industries and firms, industrial policy measures can be developed that are generic to most sectors and firms in the national economy.

Foster Regional Value Chain

Production and trade are heavily affected by international production networks, which require the combination of parts and components from many different locations and often other suppliers. This offers opportunities for developing countries to integrate into the global economy by investing in capacities to meet the global demands in intermediate goods at competitive prices and quality. Yet, disruption of global value chains during the recent Covid-19 pandemic has led industrialists to rethink value chains' current structure. This offers new opportunities for creating value chains at the regional level.

Despite some similarities, TC MSs differ in terms of their development, resources, and growth potentials. While there are enormous potentials in enhancing intra-regional cooperation and development, there are often severe challenges in fostering economic relations among the Member States. Partnership at the regional level may be critical for the development of competitive industrial sectors. It is particularly challenging for small economies to develop a competitive industrial sector because they may not have all the resources needed for an industry to grow. Industries may also benefit from the agglomeration resulting from the integration process, which would create new cross-industry externalities such as technology transfer and knowledge spillover. Moreover, the minimum market size for an industry to grow may be too big for a small economy. In this context, it is required for TC MSs to foster regional integration in selected sectors and create value chains to become competitive at the regional level.

For example, Kazakhstan has vast aluminum reserves and is trying to develop the value chain by establishing technology and special structures to produce aluminum alloys. In later stages, they also aim to create further value addition in the aluminum sector by increasing capacities to produce electric appliances. This and other initiatives provide enormous opportunities for the Member States to promote intra-regional investment and create value chains in such emerging sectors.

Promote Research and Innovation

TC MSs are investing heavily in their human capital, as they have relatively higher school attendance and literacy rates than other developing countries. However, technological progress is lagging in these countries. Investments in human capital are insufficient to translate the capacities into a more innovative structure to generate higher patent applications, casting doubt on TC MSs' quality of education. Gains in access to education should turn attention to the challenge of improving the quality of education and accelerating learning. TC MSs should focus on improving the framework conditions for innovation and thus the potential outcomes related to productivity and competitiveness in order to achieve better economic performance and greater economic integration.

In this process, it is crucial to allocate a reasonable amount of public budget to education, R&D and innovation. Training and attracting talent should be placed at the top of the national strategies for innovation. In order to ensure effective use of these resources while supporting research and innovation activities, necessary monitoring and evaluation mechanisms should

be in place. Needs for critical reforms should be quickly identified and implemented. Cooperation among the Member States in knowledge sharing and transfer should be strengthened. It is also important to note that challenges for making innovation the engine of economic development can be quite demanding in specific settings due to poor framework conditions and low human capital. Improving education attainment and quality of education and strengthening framework conditions should be priority policies in these countries. The framework conditions, which include policy environment, economic environment, regulations and procedures, access to finance, education system, protection of IP rights, and empowerment, should be well considered while devising policies for an innovation-friendly environment.

Encourage Entrepreneurial Activities

Innovation requires risk-taking behavior, and the tolerance of entrepreneurs is high in risk-taking. They engage in a 'cost-discovery' process to determine whether new goods can be produced at a lower cost and sold at competitive prices. They thereby generate further information on the viability of their activities for other economic agents. Entrepreneurship also accelerates industrialization and structural transformation by efficiently shifting resources away from traditional sectors into more modern ones. Therefore, it is vital to promote entrepreneurial activity to foster innovation and encourage diversification into new sectors. By introducing new products and organization processes, entrepreneurs also contribute to productivity growth.

Entrepreneurs face significant challenges and constraints when starting firms or upgrading their operations. These challenges are typically related to financing, infrastructure, skills, and business environment. Entrepreneurs need better infrastructure and a more supportive business environment. Infrastructure is a critical component in promoting industrialization, raising incomes, accumulating human capital, and facilitating access to markets. On the other hand, improving general economic conditions through sound fiscal and monetary policies and appropriate exchange rates, boosting the business environment, and enforcing stable regulatory frameworks can impact enterprise performance.

Upgrading skills is fundamental to better use the opportunities of new technologies for industrialization. Improving managerial skills is also essential to strengthen entrepreneurial capacity. Formal education could better integrate entrepreneurship training to raise awareness and upgrade skills necessary for successful entrepreneurship. There is a need for institutions and programs that can actively bridge the gap between industry needs and education to address the skills mismatch. Massive Open Online Courses (MOOCs) can also be a useful tool in supporting and training high-tech entrepreneurs.

Address the Challenges faced by Small and Medium-Sized Enterprises

Although small and medium-sized enterprises (SMEs) are considered a vital employment source, their role is not limited to that only. They can also be a source of dynamism in industrial development and economic diversification. However, several challenges prevent their effective participation in economic activities. Lack of access to credit is a common problem

faced by SMEs, which prevent firms from growing. In most cases, small firms lack the assets or collateral that can be used to guarantee against the loan they take out. Start-ups are more subject to credit constraints and are less resilient against financial shocks. One of the most promising solutions for providing capital to start-up entrepreneurs and SMEs is crowdfunding. Venture capital and angel investment are also widely used tools to address the credit constraints of innovative entrepreneurs.

Successful entrepreneurs and SMEs should be supported with adequate instruments to enter foreign markets and face international competition to become more productive. Thereby, they can benefit from access to know-how and cutting-edge technology, increased efficiency, economies of scale, and advanced proficiency by entering more competitive markets. Yet, productive SMEs face particular challenges in entering international markets. This commonly includes the potential customers and their needs, information about how to access to market, existing competition in the market, and finding the right partners in doing business. It is also often difficult for SMEs to get information on how to comply with foreign laws, mainly on custom rules, industrial property rights, contract enforcement, and other technical regulations and standards.

Since most SMEs that are productive enough to be exporters cannot overcome such challenges, specific support mechanisms should be developed. It is essential to start with building internal capacities to identify and manage the associated risks and opportunities. For this purpose, special mentoring and training programs can be designed to upgrade the skills required for this purpose. Moreover, governments can be more proactive in helping to acquire information on market opportunities and rules and regulations. *The First Flight* program of Ireland to support firms' internationalization can be considered an excellent example of such initiatives. Networks and clusters can be alternative tools to support the internationalization of firms.

Establish Clusters and Industrial Parks for Industrial Development

SMEs can benefit considerably from establishing sub-contracting relationships with larger firms and in some instances from clustering in specific locations to undertake joint activities and take advantage of interactions with similar firms. Clusters can be instrumental in supporting firms to grow, but also to export. Business clusters can indeed help firms to grow by overcoming the common barriers and contribute to industrial development. The proximity of firms in clusters enables the transfer of knowledge, ideas, and technology, thereby facilitating innovation. It allows firms to benefit from shared infrastructure and shared services, lowering fixed costs. Clustering also creates a pool of labor, raw materials, and suppliers, allowing firms to focus on tasks in which they have a comparative advantage.

The effectiveness of a cluster depends, among others, on the availability of adequate infrastructure and services as well as proximity and linkages with customers and markets. Industrial parks and special economic zones are clusters established by the state for industrial development aiming at attracting businesses in certain areas by providing public goods and preferential regulations. Business clusters can also help SMEs have easier access to global value chains, develop strategic alliances with research organizations in similar clusters or

networks, expand their commercial activities abroad, and obtain appropriate skills and tailored professional advice. High-tech start-up accelerators are also an essential tool in providing a combination of services, including mentorship, funding, networking, training, and office space to innovative entrepreneurs. Silicon Valley in the USA is probably the most famous and most successful example of clusters. Similarly, Germany has made extensive use of industry clusters, which act as critical mechanisms in making the German economy one of the strongest in the world.

8.3 Facilitating Trade and Investment

World trade takes place increasingly in parts and components, with each country specializing in particular stages of a good's production sequence. A key feature of this vertical specialization is that imported inputs are used to produce a country's export goods, reflecting an international labor division. A significant driving force for growing vertical specialization has been a steady decline in trade barriers. Despite several re-export and border crossings, reductions in trade barriers yield a multiplied reduction in the cost of producing a good sequentially in several countries. To take a larger share in this form of production and trade, it is required to have efficient transport mechanisms and trade facilitation measures in place.

On the other hand, the TC MSs need more significant investment in many sectors to achieve economic diversity, higher growth, and productivity. Investment in infrastructure is particularly important for landlocked countries, which suffer from a lack of connectivity. Investing in infrastructure makes it possible for producers to use modern technology. By introducing modern technology to producers, infrastructure expansion directly stimulates productive activities. Furthermore, investment in education and training increases the skilled labor force. Investment in agriculture is vital for reducing poverty. Investment also produces trade-related benefits for the member countries by facilitating regional and global economic integration. In this connection, the following recommendations are made to promote trade and investment among the Member States.

Reduce Trade Barriers and Facilitate Trade

Even though the tariff rates are at their historically lowest levels for many products, they remain one of the significant obstacles in trade among the TC MSs. Considerable barriers are also observed in official formalities. Such formalities typically include customs declarations, applications for import/export permits, and other supporting documents such as certificates of origin and trading invoices. A higher number of documents required for export, being used as a proxy for such formalities, discourage exporters and open the door for bribery and corruption. Therefore, all the formalities related to export should be transparent and easy to submit.

Some other trade facilitation measures, such as simple rules and procedures, operational flexibility, fair and consistent contract enforcement, standardization of documents, and electronic data requirements, should also be considered. In this context, the implementation of a single-window system should be promoted to facilitate trade, enabling international traders to submit regulatory documents at a single location and/or single entity. Another critical obstacle is non-tariff barriers: different sanitary and phytosanitary measures and

standards of products outlined in the Member States legislation harm trade flows. Therefore, the TC MSs could improve standards of traded products, converging them and ensuring their mutual recognition.

Moreover, due to technical difficulties in signing a possible free trade agreement among the Member states, signing a preferential trade agreement could be an alternative for facilitating trade. There is an incredibly massive potential for concluding bilateral trade facilitation agreements in the field of services. This requires strong political willingness and commitment, with the participation of the private sector as well.

Adapt Predictable, Consistent, and Transparent Trade Policies

Governments use various trade policy instruments to promote investment in targeted sectors. Custom procedures, international trade agreements, trade facilitation measures, and transparent trade policy strategies play significant roles in influencing private investors. Traders and investors like simplified procedures that can significantly reduce custom compliance costs and regulatory and administrative procedures. Unnecessarily complicated procedures make it harder for countries to reap the efficiency gains resulting from global supply chains, potentially discouraging investment. Systematic analysis should be made to evaluate the effectiveness of trade policies in promoting trade and investment. It must be ensured that protectionist trade policies do not distort resource allocation and damage the overall investment climate. Policies that favor particular industries should be devised so that they do not crowd out investment in more productive activities.

Predictable, consistent, and transparent trade policies reduce the risks for investors. Multilateral and preferential trade and investment agreements increase investor sentiments and attract more investment. Such agreements expand the market potential, allow for more significant economies of scale and reduce costs. Therefore, policymakers should be predictable in entering new deals to promote adjustments to changing competitive conditions. The promotion of investment in specific industries through trade policies also should be transparent and consistent with existing international obligations.

Establish a Well-Functioning System of Contract Enforcement and Dispute Resolution

Investment dispute settlement-related issues have been debated with increasing intensity by the international investment and development community as the number of investor-State dispute settlement (ISDS) cases surge. As the number of bilateral investment treaties rises and the private sector increasingly benefits from such treaties, the need for dispute settlement also increases. Governments seek to ensure that ISDS serves to enhance the welfare of societies.

In this regard, a well-functioning contract enforcement system and dispute resolution must be in place and widely accessible. Adequate enforcement procedures improve commercial relationships' predictability and reduce uncertainty by guaranteeing investors that their contractual rights will be maintained by law. When procedures for enforcing commercial transactions are rigid and burdensome or contractual disputes cannot be resolved in a timely and cost-effective manner, many potential investment projects will not be undertaken, and

economies will rely on less efficient commercial practices. The expropriation laws and review processes also need to be well-defined and explicit limits and channels.

Promote Public-Private Dialogue and Partnership

Public-Private Partnership (PPP) involves collaboration between the public and private sector to fulfill a long-term goal, usually for a social and economic infrastructure project that will lead to the development of an area or region. Such partnership agreements are mainly used to finance hospitals, schools, roads, rail networks, and airports in practice. PPPs can be attractive to both the government and the private sector. For the government, private financing can support increased infrastructure investment without immediately adding to government borrowing and debt and can be a source of government revenue. Simultaneously, better management in the private sector and its capacity to innovate can increase efficiency and bring better quality and lower-cost services. For the private sector, PPPs present business opportunities in areas from which it was previously excluded and expansion of products and services beyond their current capability.

The decision to involve the private sector has to be guided by assessing the relative long-term costs and benefits and availability of finance. Embarking on privately financed infrastructure projects to improve the asset bases without adequately evaluating the longer-term economic, financial and social consequences almost invariably may cause further problems. The success of private sector involvement is heavily affected by the quality of the national investment climate. Laws and agreements should be adequately enforced, and infrastructure projects should be free from corruption. Public authorities should communicate their policies' objectives and place consultative mechanisms between the public and private partners to optimize the private sector's involvement. All relevant information about projects, including the state of existing infrastructure, performance standards, and penalties in the case of non-compliance, should be disclosed. Awarding procedures should be fair, transparent, non-discriminating, and dispute resolution mechanisms should be in place. Finally, to improve the policy environment, access of the private sector to capital markets should be facilitated to fund their operation at competitive international rates. In markets where well-functioning domestic capital markets exist, the private sector is more likely to be involved in infrastructure investment.

Develop Regulatory Framework for FDI

Investment policies directly influence the decision of investors. To create an enabling investment environment, special attention should be paid to clear and transparent laws and regulations, mechanisms for settling investment disputes, protection of property rights, and non-discrimination as core investment policy principles. Investors need to understand the practical implications of rules and regulations governing their investment, in terms of the conditions to satisfy, the procedures for a public review, and the appeals process in the event of a dispute. Governments should ensure that the implementation and enforcement of laws and regulations dealing with investments and investors are clear and transparent, and they do not impose unnecessary burdens on investors. A fair, transparent, and predictable regulatory framework is a critical determinant of investment decisions and their contribution to

development. It is especially crucial for SMEs that tend to face particular challenges to entering and complying with the formal economy's rules.

Moreover, investors need to be confident that their ownership of, or right to use, the property is legally recognized and protected. Governments should implement laws and regulations to protect intellectual property rights (IPR) and introduce effective enforcement mechanisms. If the protection level is not adequate to encourage innovation and investment, new strategies, policies, and programs should be developed to meet the investors' needs for better protection. IPR gives businesses an incentive to invest in research and development, fostering innovative products and processes.

Implement Effective Tax and Competition Policies

Tax incentives are one of the instruments used by policymakers to stimulate investment. Suppose there are some underlying problems with overall investment environment, such as poor infrastructure or lack of skilled labor. In that case, it is easier for governments to provide tax incentives than to invest in addressing these problems. However, while giving particular incentives to investors, the tax system should raise revenues to strengthen the key enablers of investment ranging from human capital development to infrastructure development. Policymakers should regularly assess the adequacy of fiscal revenues to cover the costs of crucial public investments and the level of the tax burden on corporate profits to determine if the tax system is supportive of investment.

On the other hand, a competitive environment encourages risk-taking and investment. Industries facing greater competition experience faster productivity growth because competition allows more productive firms to enter and gain market share at the expense of less productive ones. Competition provides a stimulus for innovation in products and processes. Investor confidence increases in an environment where there is ample opportunity for innovation, productivity growth, and higher profits. Creating and maintaining a competitive environment requires a rigorous and well-structured competition law and an effective competition authority that enforces this law. Economic policies should be in line with the principles of competition and avoid any unfounded restrictions. Competition authorities should periodically evaluate industrial policies' costs and benefits that provide direct or indirect support to different industries to achieve specific objectives. Such policies often include state involvement through financial assistance or restriction on foreign involvement, trade barriers, and exemption from competition laws. Prolonged support of certain firms or industries may result in higher prices and lower productivity due to a lack of competitive pressures.

8.4 Supporting Partnerships in Strategic Sectors

The TC MSs have dynamic economic structures, and they achieved significant economic transformation over the last two decades. Moreover, they offer great opportunities in various sectors that they are rich and complements each other's demands. In manufacturing industries, many complementary products can be identified for trade or even for value chain creation. In this context, some broad recommendations are provided in subsection 8.2. Here,

the focus will be on three critical sectors outside of the direct manufacturing industries: energy, tourism, and agriculture.

Azerbaijan, Kazakhstan, and Uzbekistan have significant energy sources, which offer tremendous opportunities for cooperation. Similarly, richly historical, cultural, and natural landmarks in all Member States present alternative social and economic integration methods in the region through tourism development. Abundant land resources and the capacity to produce a wide variety of agricultural products in the region also offer a different prospect for partnership among the member countries. This subsection will dwell on some policy issues to tap on the potentials in these three economic sectors.

Energy

Several TC MSs have benefited extensively from their natural resources in their development, especially those endowed with rich fossil fuels and other minerals. Such natural resources offer great potential for fostering economic growth. However, to maximize the potential contribution of natural resources, they need to upscale their capacity not only in terms of extracting these sources but also adding more value to them through appropriate policies and investments.

Given the vast energy resources and significant potentials for renewable energy sources, the energy sector could be a critical driver of deepening economic relations. Despite significant connectivity challenges, designing energy policies at the regional level could create tremendous benefits to all countries due to the proximity of their markets, complementarities that may exist, and the opportunities for economies of scale. As an excellent example for regional cooperation, the STAR Refinery became operational in Turkey with a direct investment value of $6.3 billion by Azerbaijan (SOCAR) to produce value-added petroleum products such as naphtha, xylene, diesel, jet fuel, and LPG. While helping Turkey reduce its import dependency, it allowed oil from Azerbaijan and other countries to reach global markets. Identification of similar investment opportunities and their realization would significantly support economic growth and integration in the region.

While there are essential complementarities in the trade of natural energy sources, including oil and gas, renewable energy also offers significant cooperation and partnership opportunities. Underutilization of renewable energy leads to increased energy security concerns and dependence, severe environmental impacts, and sizeable economic losses. Underdeveloped technology, poor infrastructure, insufficient human capital, and lack of financial sources are among the reasons that may explain why some countries could not start exploiting the real potential of renewable energy. Nevertheless, this issue requires a paradigm shift in energy policy-making and reallocation of resources to finance renewable energy sources with alternative financing mechanisms.

Public-Private Partnership (PPP) modality provides a unique opportunity for energy investments. There are usually available funds allocated from multilateral development banks (e.g., World Bank, Islamic Development Bank, Asian Development Bank) for concrete project proposals in the renewable energy sector. Turkey's unique experiences in the renewable

energy sector can also contribute to other Member States by organizing experience-sharing, training, and capacity-building programs.

Robust mechanisms should be developed for greater cooperation at the regional level to improve physical connectivity and build institutional linkages between the energy-surplus and energy-deficit countries. This would facilitate joint investments in improving intra-regional and extra-regional energy transport and pave the way for the development, commercialization, and diffusion of energy-efficient technologies. The potential growth of regional electricity trade, for example, depends on the modernization of infrastructure. Some Member States are still partly dependent on the Soviet-era power transmission lines that connected them in the past. However, there are also new transmission lines enabling to meet local demands with regional and international organizations' support. To increase solidarity and partnership among the Member States and increase export capacities in energy, new transmission lines can be constructed.

Tourism

Located along the ancient Silk Road, TC MSs are home to a rich and diverse historical, cultural, and natural heritage that provides significant regional and international tourism development opportunities. The Member States are already active in promoting regional tourism through various initiatives, which resulted in multiple agreements such as the "Joint Cooperation Protocol on Tourism Cooperation among the Member States" and the "Cooperation Protocol among the Private Sector Umbrella Institutions of the Member States" in the tourism sector. Moreover, the successful implementation and promotion of the "Modern Silk Road Joint Tour Package" allowed to create alternative destinations for cultural tourism following new tourism trends in the world.

If properly planned and managed, international tourism could play a significant role in the Member States' economic development by promoting economic growth and creating jobs. There are, however, various challenges that prevent the development of the tourism industry. A lack of the effective infrastructure necessary for developing sustainable tourism industry, and lack of technical know-how and weak promotional activity are some of the Member States' challenges.

Despite all these challenges, there is still scope for developing a sustainable international tourism industry in TC MSs. Among the niche tourism sub-sectors, Islamic tourism has a great potential for developing the tourism sector. There is an increasing awareness about Islamic tourism's social, economic, and cultural possibilities at the top policymakers' level, including Turkey and Uzbekistan. Another alternative avenue for growth in the tourism domain is health tourism, which could diversify tourism products and services such as medical tourism, wellness, or spa tourism. Again, Turkey, invests in its capacities to become a major health tourism destination.

It is necessary to invest in basic tourism-related infrastructure. The quality and efficiency of the basic tourism-related infrastructure and services such as hotels, roads, public amenities, transportation and communication, tourism information, and visa regulations should be

improved based on international standards to provide world-class services to visitors and tourists. Investing in such services would help host more tourists and increase their satisfaction with the quality of services that would promote the country's tourism image.

At the regional level, joint programs and promotional materials on tourism, such as TV programs, brochures, posters, and guidebooks, should be developed and made available to the Member States as well as to other countries around the world in order to promote the cultural heritage, diversity, and niche tourism markets of the member countries.

Carrying out joint vocational training presents the cornerstone of cooperation among the Member States in tourism. Turkey already provides vocational training programs in the service sector for tourism employees in coordination with relevant ministries and tourism associations. Additional capacity building and training programs on various aspects of the tourism sector, including niche sectors with high potentials such as health and Islamic tourism, could be developed and organized. This also requires establishing linkages or networks among relevant authorities in the Member States to facilitate the exchange of experts and research on tourism development. The organization of tourism fairs, festivals, and exhibitions could also help support the region's tourism industry.

Agriculture

While Turkey can diversify its agricultural production due to its favorable climate conditions, other Member States have limited agricultural diversity opportunities. However, there are great cooperation opportunities within the region to strengthen the agricultural value chain and trade linkages. Wheat is the main agricultural product in Kazakhstan, Kyrgyzstan, Uzbekistan, and Azerbaijan. Its widespread usage by households makes it the most important crop for regional food security. Therefore, supporting the production of wheat has been traditionally a state policy in these countries. According to FAOSTAT, almost 60% of the arable land area was allocated for wheat production in Kazakhstan (and 54% in Uzbekistan). Given its vast agricultural lands, this makes Kazakhstan worldwide one of the largest producers of wheat. Improved connectivity with the countries in the region and outside of the region facilitate increasing its export capacity. Nevertheless, more favorable climate conditions in Turkey and Azerbaijan allow these countries to grow various horticulture products. Fruit and vegetable production is also increasing in Kazakhstan and Uzbekistan.

The diversity of agricultural land in terms of topography and climate makes it particularly difficult to design agricultural policies at individual country level, let alone at the regional level. However, national strategies towards developing the agricultural sector and productivity generally focus on diversification of agricultural production, improved irrigation systems, and targeted subsidies towards horticultural production.

To achieve greater economic integration in the agricultural sector, more concentration is needed to create value chains, which are typically spurred by new consumption patterns and new production and distribution systems. Even if multinational or national firms and supermarkets often control them, such systems would require developing trade and logistics

centers and improving national food processing capacity by increasing the number of storage facilities to address the limitations faced by small farmers.

It is also essential to recognize the importance of agro-industrial development for better economic performance and greater integration. Therefore, agro-industrial development should be promoted by allocating adequate resources to develop and utilize raw material selection and socially appropriate technologies. Development and strengthening of institutional infrastructure, training of personnel in technology, management, entrepreneurship, research and development are crucial factors in improving the product quality and safety in fostering agro-industrial development. The establishment of regional cooperation and strengthening the national centres to select appropriate technologies would fill a critical gap in developing food and agricultural products processing industries in the region.

Due to significant constraints faced in the region in terms of land and water resources for agricultural production, there is also a need for greater environmental sustainability. Regional partnership in the sustainable use of water resources should be at the heart of regional cooperation. Finally, to improve agricultural productivity, more significant partnerships in capacity building, research and innovation should be part of the cooperation agreements. Joint mechanisms towards knowledge sharing in research, development, and technology adoption would help build up national capacities.

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