

# Trends and patterns in foreign trade of Central Asian countries



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## Introduction

Central Asia is a region which possesses rich natural resources, an educated labour force, cultural diversity and strategic location, especially proximity to China. Conversely, the region is landlocked and remote from most global economic centres, it has a small population and market size, underdeveloped infrastructure, and in some areas suffers from political instability and insecurity; all of which create risks for human development. The relationship between the multiple forces driving development and risks is dynamic. Understanding these dynamics requires consistent monitoring and careful evidence-based analysis of key development factors in the region.

One of the most important factors of economic development is foreign trade, and Central Asia has economies heavily dependent on trade. Below we discuss recent trends and patterns in the total and intra-regional trade of Central Asian (CA) countries and assess their importance and policy implications. Trade between CA countries is considered in more detail, and the analysis covers both formal and informal trade flows.

**“Almost all CA countries have ambitions to make a transition from the export of primary products to products/services with higher value added. The most natural markets for these products/services are their neighbours”**

The paper distinguishes between informal trade flows in consumer goods with welfare-increasing potential, and illicit trade in goods such as narcotics and weapons. The latter trade, although present in the region and important for some countries, is seen to have limited impact on legal economic activities and is therefore excluded from consideration.

In this study, the period under consideration is from 2000 to 2010 and the region of Central Asia includes Afghanistan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Afghanistan is not always considered part of Central Asia. However, from a trade perspective, the ties

between Afghanistan and its northern neighbours are increasingly important and have the potential for substantial growth. Therefore, in this analysis, it is useful to include Afghanistan in the broader CA context.

## 1. Environment for trade development in the region

The first decade of the 2000s appeared to be a period of economic recovery in Central Asia. All CA countries demonstrated good economic growth: Turkmenistan recorded a double-digit average annual GDP growth rate, and in Afghanistan, Kazakhstan and Tajikistan these growth rates exceeded 8%.

Other macroeconomic factors directly affecting trade include inflation and exchange rate. Inflation in the region in 2000s was quite high. Only Afghanistan and Kyrgyzstan had average inflation rates somewhat below 10% per annum; in Tajikistan and Uzbekistan the decade's average annual inflation rate exceeded 20%. Due to high inflation, the exchange rates of all national currencies in the region appreciated in real terms against the US\$ and the Chinese yuan. This real appreciation of regional currencies reduced price competitiveness of commodities produced in these countries on both domestic and export markets.

Trade policies in the region are not particularly restrictive; for example, simple average most-favourable nation import tariffs are in the range 5-15%, which is not high by global standards. There were no dramatic changes in the trade regimes of CA countries in the 2000s. The only important change - the creation of the CU of Belarus, Kazakhstan and Russia - materialized in 2010 and thus did not significantly influence trade flows in the period under consideration.

An important impediment for trade in the region is the insufficient development and poor condition of infrastructure and trade facilitation. These factors are captured by the logistics performance index (LPI) developed by the World Bank. In general, CA countries, especially the smaller ones, do not fare well on the majority of LPI components. Key barriers for trade for these countries are associated with the inadequate quality of trade and transport infrastructure, underdeveloped logistics services, as well as inefficient custom clearance processes. Nonetheless, a comparison of 2007 and 2010 LPI values indicates that all countries of

the region, and in particular Kazakhstan and Uzbekistan, achieved visible progress.

According to the LPI, the most notable improvements were in rankings for infrastructure and timeliness of international shipments. These improvements could be a result of massive investments into transport and energy infrastructure in the countries of the region by foreign partners and international development organisations. Examples of large projects include the construction of oil and gas pipelines from Kazakhstan and Turkmenistan to China, the electricity transmission line from Uzbekistan to Afghanistan, and the rehabilitation of automobile road corridors in almost all countries of the region.

Apart from domestic policies and structural issues, trade performance of CA countries from 2000 to 2010 was affected by fluctuations in international commodity prices. International energy and metal prices rose from 1999 to 2008, dropped from 2008 to 2009, and recovered from 2009 to 2010. All CA countries, apart from Afghanistan, specialize in the export of energy products and metals, and some depend heavily on energy imports. So the region was strongly affected by these price developments.

As shown in Figure 1, countries which are net energy exporters (Kazakhstan, Turkmenistan, and Uzbekistan) enjoyed a dramatic improvement in their terms of trade measured by the net barter terms of trade index. In Afghanistan and Kyrgyzstan, price improvements for export commodities were mostly offset by increased fuel prices. For Tajikistan, imported energy price growth resulted in deterioration of its terms of trade from 2007 to 2010.

## 2. Foreign trade flows in Central Asia in 2000-2010

### 2.1 Merchandise trade

All CA countries demonstrated very good growth of trade in 2000-2010. Trade turnover expressed in USD increased many times in every country of the region (Table 1). The role of trade in these economies has grown correspondingly; the share of trade turnover in GDP increased very substantially in all countries.

As could be seen from Table 1, CA countries are split into net exporters (energy-rich Kazakhstan, Turkmenistan and Uzbekistan) and net importers (Afghanistan, Kyrgyzstan, and Tajikistan). Energy exporters did very well during the decade under consideration, and their exports increased many-fold mostly due to the above-mentioned positive shock in terms of trade (see Figure 1).

Positive or negative, trade balances in almost all these countries have been large and increasing. Net exporters accumulate their trade surplus in national funds or use other arrangements to invest export revenues; net importers finance their trade deficits through remittances, FDI, and foreign aid. So, exports and imports in all these countries are decoupled; export revenues are used not only for financing imports and are not necessarily the largest source of imports financing.

It is typical for all CA countries to have exports concentrated on just few commodities (Table 2). Key export commodities of CA countries include energy products (crude petroleum oil and natural gas), metals and ores (iron, copper, gold, aluminium etc.) and selected agricultural commodities (eg. cotton and wheat).

Another common feature of trade dynamics in CA countries is the strong increase in imports. This could be due to robust growth of GDP and domestic demand in the region after 2000 and the strengthening of national currencies (see Section 1). As a result, the economies of the region are more open now than they were in 2000.

The main export partners of CA countries are the EU, Russia and China. The roles of the EU and China as export markets increased dramatically between 2000 and 2010. Russia's role as export market for CA economies has reduced but remains large and exports to this country increased in real terms in 2010 in comparison to 2000.

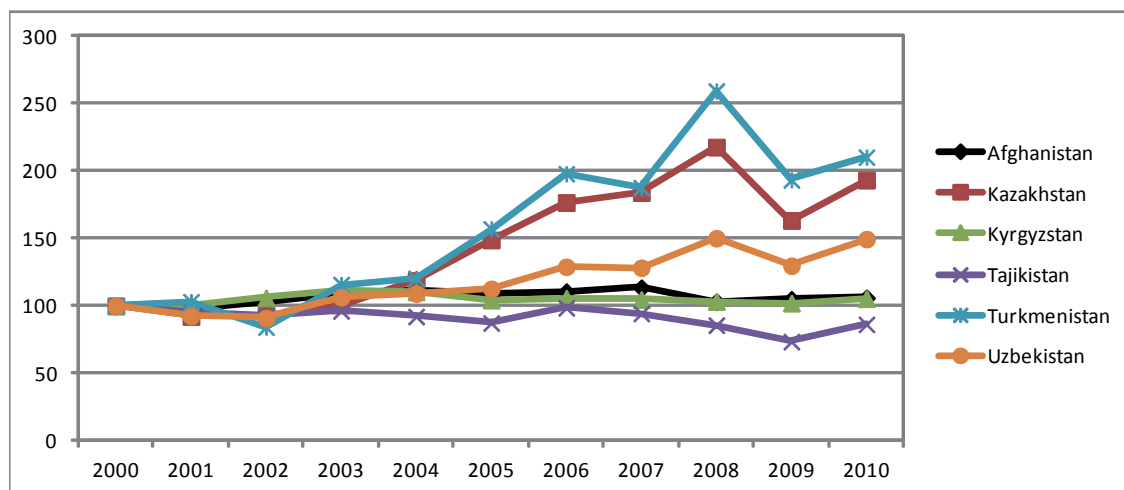
Unlike exports to the EU and China, which consist predominantly of hydrocarbons and metals, exports to Russia are more diversified and the share of manufactured

**Table 1<sup>1</sup>. Commodity trade turnover and balance**

Country	Trade turnover				Trade balance	
	2000 <sup>1</sup>	2010	2000 <sup>1</sup>	2010	2000 <sup>1</sup>	2010
	Billion USD		% of GDP (at purchasing power parity)			
Afghanistan	1.3	10.7	10.2	38.9	-8.7	-35.3
Kazakhstan	13.8	90.7	19.3	45.9	5.2	14.7
Kyrgyzstan	1.1	4.7	16.1	39.1	-0.8	-14.4
Tajikistan	1.7	3.9	30.8	32.0	-0.4	-12.1
Turkmenistan	4.3	17.9	48.5	48.3	8.1	4.0
Uzbekistan	5.5	20.2	15.6	23.5	0.3	4.0

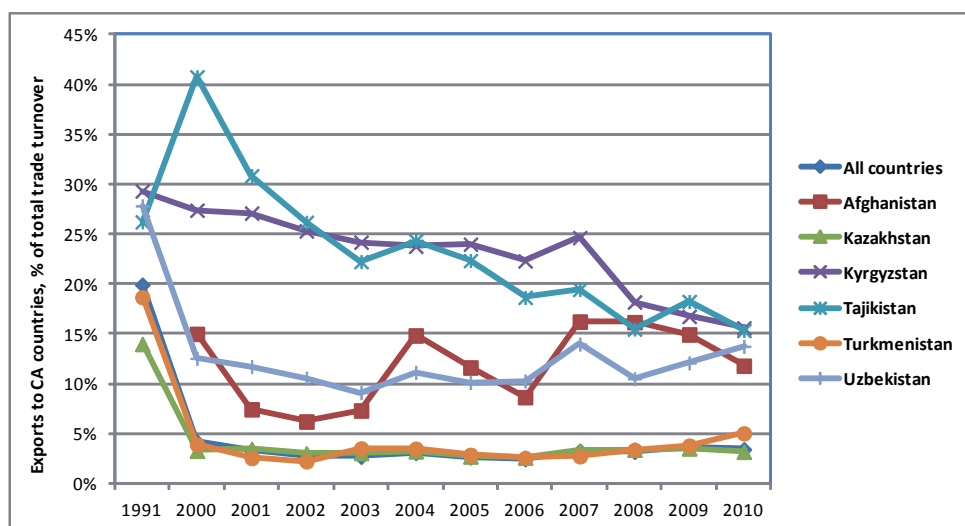
Sources: author's calculations based on COMTRADE database, IMF and CA countries' national statistical sources

**Figure 1. Dynamics of net barter terms of trade index in Central Asia**



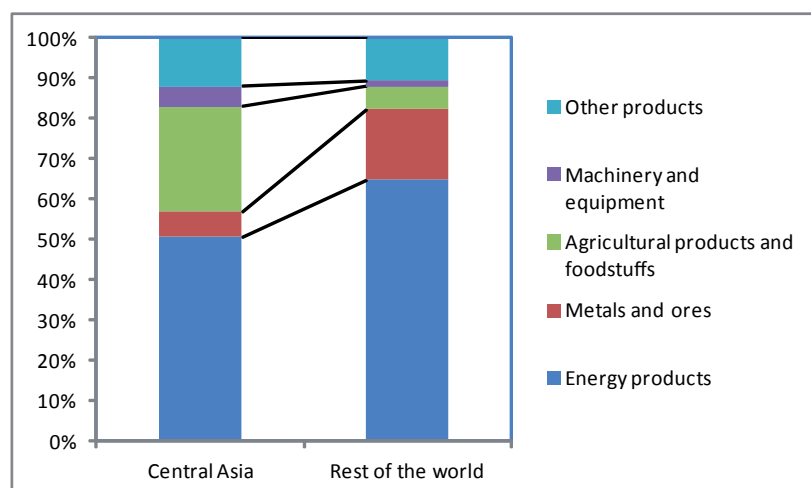
Sources: World Development Indicators and author's calculations

**Figure 2. Dynamics of intra-regional trade turnover**



Sources: COMTRADE, IMF, World Bank, national statistical agencies of CA countries

**Figure 3. Commodity structure of exports of countries of the region to Central Asia vs. the rest of the world**



Sources: COMTRADE, national statistical agencies of CA countries

products in these exports is higher, with Russia being the main destination of Uzbek cars, Kazakh machinery and Kyrgyz garments.

Changes in the geographical structure of CA imports have been less significant. Russia continues to be the main source of imports for the region, supplying energy and manufactured products. The EU is in second place, providing various machinery and equipment to Central Asia.

Over the decade, China progressed from providing few imports to Central Asia in 2000 to providing over 10% of total imports to the region in 2010, making it the third largest source of imports, according to CA countries' official data. The data do not take into account huge informal imports of Chinese consumer goods, especially textiles (see Section 3.2).

### 2.2 Trade in services

Available data for CA countries show that exports of services are important only for Kyrgyzstan and Tajikistan. In Kyrgyzstan, in recent years, exports of services were as high as 60% of exports of goods. Exports of services from this country are driven by travel/tourism which provide 40-60% of total service export revenues depending on the success of a given tourism season on Issyk-Kul lake shore. Tajikistan's main exported service is melting of aluminium from imported alumina using cheap electricity in the country. In Kazakhstan and Uzbekistan, exports of services are not as important as the exports of goods.

Imports of services are relatively high in Kazakhstan, where they remain mostly above 30% of imports of goods. Key components of imported services are geophysical services

**Table 2. Key export commodities, 2010**

Country	Commodity	% of total exports
Afghanistan	Dried fruits	45
	Carpets and rugs	37
Kazakhstan	Crude petroleum oil	60
	Iron and steel	7
Kyrgyzstan	Gold	45
	Radioactive chemical elements	11
	Garments	8
Tajikistan	Unwrought aluminium	62
	Cotton	17
Turkmenistan	Natural gas	53
	Oil products	21
	Crude petroleum oil	11
Uzbekistan	Natural gas and other mineral fuels	25
	Gold	24
	Cotton	17

Sources: author's calculations based on COMTRADE database and CA countries' national statistical sources

related to oil and mineral exploration (20-50% of the total imports of services) and construction services (17-35% of the total imports of services). These imports accompany massive export-promoting investments in mineral deposits and infrastructure projects including pipelines. In Kyrgyzstan and Tajikistan, key imported services include air transportation and travel (up to a half of total imports of services), which are related to labour migration and travel of shuttle traders carrying a substantial part of merchandise trade in these economies. Thus, in CA countries imports of services are closely linked to the exports and imports of goods.

### 3. Intra-regional trade

Trade between countries of Central Asia has two major components. The first is formal trade between legal public or private entities implemented according to the regular trade regime, which means payment of all statutory import/export taxes, registration of trade transactions in official statistics etc. The second is informal trade, which is typically implemented by physical persons. The regime applied to this trade in many CA countries is much simpler than the formal one. For example, there are some tax-free allowances for shipments of small weights; for larger shipments, taxes are often levied based on weight and not on the custom value of imported goods; and production certification requirements are simpler or absent.

#### 3.1. Formal trade

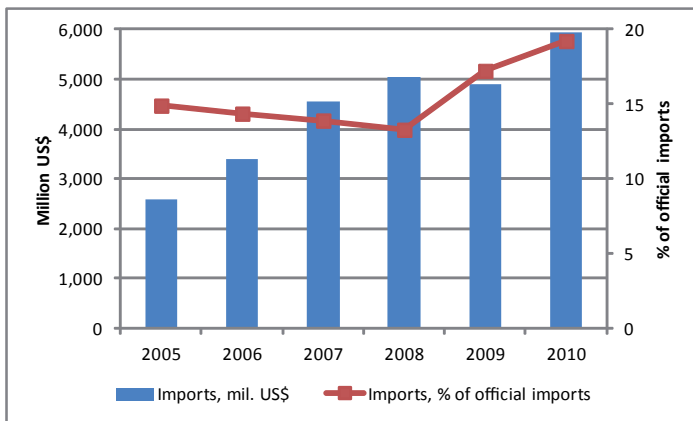
Intra-regional turnover of formal trade (defined as the sum of each region country's exports to other countries of the region) is rather small in comparison to the total trade of CA countries (Figure 2). In 2010, intra-regional turnover was a mere 3.5% of the total trade turnover of these countries.

The low level of aggregate regional trade integration indicators is due to Kazakhstan and Turkmenistan, which account for more than two-thirds of total trade turnover of the CA countries and depend very little on trade with other countries of the region. Kyrgyzstan and Tajikistan used to be heavily reliant on trade with other CA countries, but by 2010 this dependence fell to 10-20% of their total exports/imports. An important reason for the decline of intra-regional trade was the dramatic contraction of trade with Uzbekistan, a major trade partner in 2000, but not in 2010.

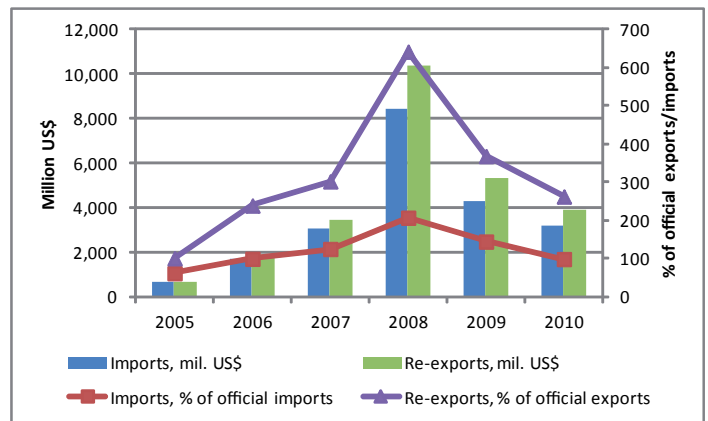
In particular, trade in electricity between Kyrgyzstan and Tajikistan, on one side, and Uzbekistan, on the other side, virtually disappeared for a decade. However, regional trade remains important for Uzbekistan. The decline in trade with Kyrgyzstan and Tajikistan was compensated by considerable expansion of trade in energy products and foods with Kazakhstan and, increasingly, with Afghanistan.

**Figure 4. Dynamics of informal trade in light industry products in selected Central Asian countries**

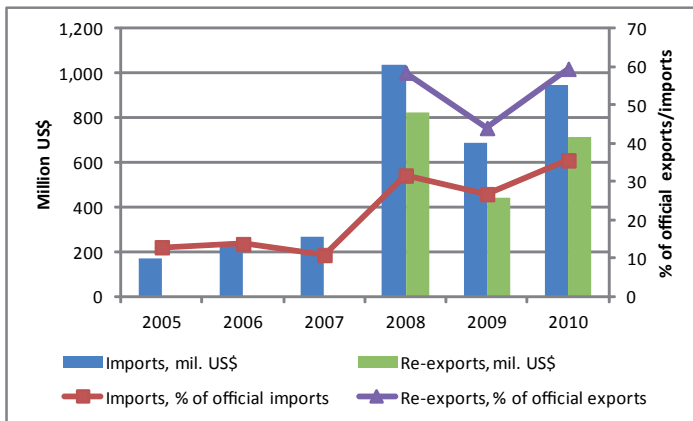
**a) Kazakhstan**



**b) Kyrgyzstan**



**c) Tajikistan**



Sources: COMTRADE, national statistical agencies, and author's estimates

Additionally, while intra-regional trade is not very large for each CA country, it is quite important for certain segments of their trade. A comparison of the commodity structure of exports directed to the countries of the region and to the countries outside the region (Figure 3) indicates that trade in agricultural products (other than cotton fibre), foodstuffs and manufactured products ('Machinery and equipment', and construction materials, fertilizers and other chemicals included into 'Other products' category) occupies much larger share in intra-regional trade than that in trade with the rest of the world.

Regional markets are even more important for exports of services and especially tourism services. For example, service export destinations for Kyrgyzstan, the country the most dependent on these exports, are Kazakhstan, Uzbekistan and Tajikistan, as well as Russia.

**3.2. Informal trade and re-exports**

Informal trade plays an important role in Central Asia<sup>2</sup>. At the centre of this trade are Chinese commodities (consumer goods including textiles and footwear) which are massively

imported to Kazakhstan, Kyrgyzstan and Tajikistan by physical persons, for which these countries have special import regimes with very low taxes; some of these commodities are re-exported further to other countries. Re-exports are especially important for Kyrgyzstan and Tajikistan. Primary re-export destinations for Kyrgyzstan are Russia, Kazakhstan and Uzbekistan; for Tajikistan they are Afghanistan and, possibly, Uzbekistan.

One relatively recent development to this trade in Kyrgyzstan is the gradual conversion of pure trading activity via re-exports of Chinese goods into the production of garments using Chinese inputs (fabrics, accessories and machinery) and the Kyrgyz labour force; this is now a large sector of the Kyrgyz economy.

By its very nature, informal trade is neither easy nor straightforward to measure. One approach to measuring informal trade volumes has been proposed by Kaminski<sup>3</sup>. Since CA countries' official statistics do not provide adequate coverage of these trade flows, Chinese mirror statistics (data on exports of China to CA countries) and its difference from

CA data could serve as an alternative source of information. To assess the volume of informal import or re-export flows of light industry products in Central Asia it is possible to use the supply and demand balance approach.

Sources of supply are imports and domestic production while demand includes domestic consumption and exports. The difference between total supply and total demand can be interpreted as informal indirect imports if negative, or re-exports if positive. In this study we use CA national statistics data for domestic production, consumption and exports and mirror statistics for imports. Calculations show that in 2010 the difference between total supply and total demand appeared to be positive for Kyrgyzstan and Tajikistan and negative for Kazakhstan and Uzbekistan.

It is well-known that re-export flows are very large in Kyrgyzstan – over twice the official exports total value. Re-exports are very significant for Tajikistan, too. In Kazakhstan, informal imports directly coming from China are complemented by those supplied via (and partially processed in) Kyrgyzstan. Finally, Uzbekistan appears to be a major recipient of informal imports (17.4% of official imports in 2010). In general, informal intra-regional trade turnover in 2010 was approximately US\$2.7 billion, which is comparable in value to formal trade. It also follows from calculations that informal imports from China are larger than formal ones.

This methodology also allows an estimate of the dynamics of informal trade flows in recent years (Figure 4). In Kazakhstan, informal imports grew steadily approaching the level of almost US\$6 billion or almost 20% of total official imports.

In Kyrgyzstan, informal imports grew explosively from 2005 to 2008, exceeding US\$8 billion or 200% of total official imports, and re-exports exceeding US\$10 billion or 640% of total official exports in 2008. However, in 2009-2010 informal trade flows in Kyrgyzstan declined due to general crisis-related reduction of demand in all final destination countries and because of domestic political instability. Starting from 2008, Tajikistan became the second re-exporter in the Central Asia.

These estimates also suggest that informal trade makes a substantial contribution to GDP of these countries. In 2010 in Kyrgyzstan, the value added of informal trade and garments production was the largest in the region, estimated at 16.5% of GDP. In Kazakhstan, Tajikistan and Uzbekistan, the estimated impact of informal trade on GDP is smaller but significant, at 0.6%, 2.4% and 0.4% GDP respectively.

### 3.3. Trade with Afghanistan

Trade linkages between Afghanistan and other CA countries have improved significantly, when the anti-terrorist

coalition launched operations in Afghanistan in 2001. CA countries provide considerable logistical support to the coalition operations. Gradually, bilateral trade relationships between Afghanistan and other countries of the region have strengthened.

In 2010, these countries provided about 12% of Afghanistan's total imports and absorbed some 8% of this country's exports. Exports to Afghanistan consist primarily of energy products (oil products, electricity); for Kazakhstan the most important export item is wheat flour. Exports from Afghanistan to other CA countries are much smaller in absolute terms, and the main recipient of Afghanistan's goods (cement, agricultural products and machinery) is Tajikistan. Thus, trade of Afghanistan with other CA countries is concentrated on a few commodities is below its level achieved in 1970s.

As follows from the above discussion, informal trade between Afghanistan and Tajikistan is probably worth several hundred million US\$ and is as important as formal trade.

### 4. Policy implications

The observed trends and patterns of trade in Central Asia suggest a number of important policy implications:

- Almost all CA countries have ambitions to make a transition from the export of primary products to products/services with higher value added. The most natural markets for these products/services are their neighbours. Regional trade policy should, therefore, be an important item on CA countries' policy agendas.
- Development of transport and energy infrastructure in the region has demonstrated its capacity to increase trade volumes and change trade structure significantly.
- Protective trade policies in the region do not seem effective either for export promotion (almost no manufactured exports), or for import substitution (as the large scale of informal trade suggests).
- Formal and informal foreign trade is important for both economic and social development of CA countries. Trade lowers consumer prices, provides the government budget revenues needed for social infrastructure maintenance, and increases employment opportunities for key social groups such as women, overall contributing to poverty reduction and social equality in Central Asia.

In conclusion, any pragmatic and viable long-term development strategy for CA countries should place trade, including regional trade, high on the agenda. ■

1. 2002 for Afghanistan.

2. Bartłomiej Kaminski, "How the Kyrgyz Republic Has Seized Opportunities Offered by Central Asia's Economic Recovery" (Washington DC: World Bank, 2008).

3. Kaminski, 2008.