CHAPTER II
ECONOMIC LIBERALIZATION IN CENTRAL AND SOUTH ASIAN REGION

This chapter will discuss and analyse the economic liberalisation process in general and Central Asian and South Asian region’s Trade liberalisation in particular. Broadly, this will present a cross-country analysis of economic policy regimes in both regions in the last two decades and will assess the transformation phase of both the regions. Brief history and some similarities of the regions will be discussed. It will also discuss the challenges and compare the transition from one system to another system. The transition processes from market economy to planned economy or from planned economy to market economy involves a complex process of institutional, structural and behavioral changes. How these regions proceed towards new system, gradually or through shock therapy, will be assessed in this chapter. To fulfil the objective of this study, and to know the developments of economic liberalisation in both the regions, it is important to understand the process of transformation. Transformation took place in all the areas such as fiscal adjustments, stabilisation, structural reforms and external sectors reforms. While understanding all reforms, this study will concentrate on only external sector reforms of the economies of both the regions. How these regions dealt with the price liberalisation and trade liberalisation will be discussed. How these regions have been competing with the international prices and trying to integrate with world will also be analysed in this chapter.

Brief History and Similarities of the Regions
The Central Asia region mainly consists of the five Central Asian republics - Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, which is the home of 50.25 million people. South Asia, consists of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, which has population of about 1.5 billion people (in 2001). These regions have high man power and natural resources, which are essential for human life and advancement. They have man power hydel power, mineral wealth and natural resources. But these regions are suffering from lack of knowledge and will power. Political stability is another requirement for economic and industrial recovery. These countries have labor resources in abundance. They are prone to the high pace of the
demographic growth. Acute shortage of domestic savings and capital accumulation is another critical challenge that they are facing.

Both the regions were under the colonialism. Russian Empire ruled Central Asia and British Empire ruled the South Asia. With the rise of the Soviet Union, Central Asia became integrated to the Soviet Command Economy, but remained geographically and economically distant from the Soviet Empire, It was largely cut off from rest of the world, including its immediate neighbors and historic trade partners (Afghanistan, Iran, and South Asia Subcontinent) (Central Asia Human Development Report, 2005.) Practically all the South Asian and Central Asian countries have introduced economic reforms and have undertaken liberalization measures which are aimed at integrating their economies with the global economy. The progress of regional cooperation will enlarge mutual interest within the regions as well as with each other. In the long run, it will help in solving the development problems of the regions and will also create an environment for friendship. Both the regions are undergoing the liberalization process, speed and sequence varies in the countries of both the regions. While going through the liberalization process these regions face many challenges which will be discussed and analyzed in this chapter, It’s very important to understand the brief history about these regions before proceeding towards analysis of economic liberalization policies.

**Brief History of Central Asia.**

This region is located in the center of the Eurasian continent. It is bordered on the north by the Russian Federation, on the south by Iran and Afghanistan, and on the east by the Xinjiang Uygur Autonomous Region of the People's Republic of China (PRC). Azerbaijan, a member of the Caucasus, lies on the western side of the region near Turkmenistan. Despite having rich endowment of mineral resources, these economies were characterized as low level of industrialization, large rural population, high population growth, authoritarian regimes, internal and external threats and ethnic problems and a relatively high degree of poverty. To know the perspective of Central Asian people, one can not understand the recent changes in the economy of Central Asia without knowing its historical background. Historically Central Asian economic developments can be divided into three main periods: pre-Revolutionary period, Soviet Period and Post Soviet period.
The level of economic development was extremely low during the pre-revolutionary tsarist era (as part of the Russian Empire until 1917). This period witnessed the establishment of the forts and creations of new cities and settlements, commercial routes, educational institutions, postal systems and railroads. New agricultural crops like cotton, potatoes, sugar beets etc. were introduced at this time. Most of Central Asia was incorporated into the Russian Empire in the 1860s and 1870s, and was subsequently developed as a supplier of cotton to mills in Russia (Richard, 2003). In the Soviet era the Central Asian republics were open economies, supplying raw materials (cotton, oil, gas and minerals) to the rest of the USSR, but insulated from the global economy.

During this period Central Asia lacked access to sea and was separated from the main trade routes. But during the Soviet period, the military and economic requirement of the USSR gave some importance to this region. These include the development of agriculture as well as considerable achievements in the fields of culture, science, education and public health (Rumer, 2003). During this period industrialization enveloped the entire Soviet Russia. Kazakhstan and Uzbekistan offer instructive examples of the most industrially developed countries in Central Asia. The inward-oriented trade patterns within the centrally planned Soviet economy were reinforced by transport, pipeline, and other communications facilities. The railways and pipelines led to Russia, and most air services and international phone lines passed through a Moscow hub. (Richard, 2003)

The modernization and industrialization had been uneven and was not guided by a long term strategy. The burden of the whole Soviet Union fell on Uzbekistan and Kazakhstan. Central Asian Countries are geographically land locked and resource rich countries. At the time of independence the economic conditions of the region were not favorable for sustainable development strategy. There was also a loss of subsidies for budgets, enterprises and households which was earlier paid directly or indirectly through social payments. There was also a loss of administrative structure and skilled labors. (Kazakhstan stretches from the Chinese border to the Caspian Sea and is bounded by Russia, Uzbekistan and Kyrgyzstan. Ethnically this country diverse whose population includes over hundred nationalities, about 60% population live in urban areas. Kazakhstan has half of the Former Soviet Unions total deposits of the resources like copper, lead and zinc. Other minerals like, coal tungsten, oil, nickel, chromium,
molybdenum, manganese are also available in Kazakhstan. It has the second largest oil field in the world in Kasagan and sits on an estimated 3 billion tones of oil and 2 trillion tones of gas. In agriculture grains, sugar beet, potatoes vegetables, meat, milk, eggs and cotton are the main crops in Kazakhstan. It has been noted for its sheep which yields high quality of wool. It is also popular for its industries as iron ore, sulphuric acid, agricultural machinery, ferroconcrete, knitwear, footwear, hosiery.

*Kyrgyzstan* is situated on the Tien-shan Mountains. It has China, Kazakhstan, Uzbekistan and Tajikistan as neighbors. It has been famous for its livestock breeding, grain, cotton, potatoes. Vegetable fruits, meat milk, eggs, wool tobacco are the products obtained here, Bee keeping is well developed Main industries are sugar, food, cotton, wool, tanning, flourmills, tobaccos, timber, textiles, engineering, metallurgy, oil and mining.

*Tajikistan* is boarded by Uzbekistan, Kirghizia, China, and Afghanistan. Farming horticulture and cattle breeding are the main occupations. Products like grain, potatoes, vegetables, fruit, grapes, meat, milk, eggs, wool and cotton are available here. Tajikistan is rich in resources like brown coal, lead, zinc, oil uranium, radium and arsenic. Some industries like mining, engineering, food textiles, clothing, silk, bricks, ferroconcrete, knitwear and footwear are set up in this country.

*Turkmenistan* is bounded by the Caspian Sea on the west. Its neighbors are Uzbekistan, Iran and Afghanistan. Maize, grapes, fruits and vegetables, cotton are the main agricultural products. Natural resources like ozocerite, oil coal, sulphur, salt magnesium and extensive oil and gas reserves give Turkmenistan an edge over the other Central Asian Countries. Food Textiles, Chemical, cement agricultural implements, ferroconcrete, footwear, knitwear are the main industrial set up in this country. Uzbekistan is bordered by Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan and Turkmenistan.

*Uzbekistan* has an excellent record in agriculture. Intensive farming, based on artificial irrigation is practiced here. It is the chief cotton growing area in the former Soviet Union and third in the world. Crops like cotton, grain, potatoes, vegetables, grapes, fruits and berries are the main products of this county. This country is rich in resources like oil, coal, copper ozocerite building materials. Agricultural machinery, cement textiles paper
ferroconcrete are the main industries available here. All the five countries of Central Asia have started liberalizing their economies since the onset of independence in 1991.

**Brief History of South Asia**

South Asian economy encompasses traditional village farming, modern agriculture, handicrafts a wide range of modern and traditional industries and a multitude of support services. South Asian region is blessed with exceptional diversities of natural and manmade resources such as land forms and climate regimes ranging from sea level to the highest mountains and deep gorges; hottest plains to snow clad mountains; wettest to driest places; dissected green valley to coral islands. Thousands of rivers with immense hydroelectric potentials, mineral resources such as Coal, iron, natural gas etc. are available in this region. This region is also blessed with extensive diversity of forest resources including extensive variety of animals, herbs and timber\(^6\). (Kumar, 2003)

South Asia, emerging from colonialism after the Second World War, was also primarily agrarian in the late 1940s. South Asia has also inherited from the colonial period common institutional and legal infrastructures and a common physical infrastructure of roads, railways and inland waterways. Mostly they developed the port areas to export things from south Asia. These got disrupted and disconnected at places, because of prolonged neglect, disuse and even deliberate destruction during periods of conflict. These can be restored without much cost. South Asia has a market consisting of 1.3 billion consumers with rising incomes. And lastly, over the last two decades, there has been a convergence of the macroeconomic policies of these countries and also diversification of their economies along similar lines\(^7\).

The major economies of South Asia grew slowly at first, but began to pick up momentum in the mid-1980s and may now be in the early phases of sustainable high growth. There are some signs in India, Sri Lanka and Bangladesh that their economies may be moving again toward the higher growth rates after 1990s.

**India** Indian economy is not only becoming stronger, more competitive globally and increasingly resistance to absorb external shocks and also seems confidently poised for higher rate of growth in a stable environment. Minerals resources like coal and lignite, bauxite, chromites, copper, gold, iron ore, lead-zinc, manganese, nickel, Tungsten, Barytes, Diamonds, Dolomite, fire clay, fluor spar, gypsum, Graphite, Limestone, Mica,
Magnesite etc. are found in India. Economic reforms started in the early eighties, but a comprehensive liberalization and privatization process started in July 1991 in the backdrop of the balance of payment crisis and foreign exchange liquidity crisis faced by the economy. Since then, there have been attempts to integrate the Indian economy with the rest of the world in a variety of ways, i.e., the removal of quantitative restrictions, reducing tariffs and exchange rate flexibility. India launched its second-generation reforms in 2002, with a focus on reducing the fiscal deficit, improving infrastructure, reforming labor laws and energizing the states to participate actively in stepping up the pace of reforms. India raised its FDI limits in many important sectors including telecommunication, banking and insurance and civil aviation.

*Pakistan* is primarily an agricultural economy. Wheat is the main subsistence crop, fruits and livestock are important in north. Pakistan is not yet self-sufficient in food production. Its diverse mineral resources are yet to be fully developed, but low grade coal and iron ore, chromites gypsym and limestone are being mined. Deposits of natural gas and oil are potentially large. Pakistan exports wool and cotton textiles and leather goods and has a growing industrial base. Though several reform measures were carried out prior to 2001, formally the economic reforms program had its genesis in the year 2001 when Pakistan signed a three year arrangement with IMF under the Poverty Reduction and Growth Facility (PRGF) program. Since its approval, seven program reviews have been completed successfully and discussions for the eighth review have been scheduled for April 2006. The key to restoring growth has been the authorities' determined implementation of sound financial policies and structural reforms including tax reform, financial sector reform, investment policies including FDI policy, and enterprise reform. These policies have reduced distortions and increased efficiency, and also lifted uncertainty about the future course of economic policies.

*Bangladesh* is surrounded by India, Myanmar and Bay of Bangal. A republic of South Asia, Bangladesh was formerly East Pakistan. East Pakistan became an independent entity named Bangladesh on 16 Dec 1971. Most people live in rural areas and make their living from agriculture. Major reforms were implemented as a part of structural adjustment policies under the auspices of the World Bank and the IMF in the 1980s and early 1990s. The efforts started with World Bank Structural and Sectoral Adjustment
loans (SALs and SECLs) in 1980. IMF introduced a three-year Structural Adjustment Facility (SAF) in 1986 under which major reform initiatives were undertaken in areas such as agricultural policy, trade and industrial policy, along with privatization and public enterprise reforms, fiscal policy reform and financial sector reform. Moreover, the implementation of these reforms gained momentum during the 1990s.

**Bhutan** economy is largely subsistence economy. People are engaged in subsistence farming; and barter is practiced. The transition to market economy has changed social life. Large deposits of lime stone, graphite, lead, copper, slate coal, talc, gypsum, beryl, mica, pyrites and tufa have been found. Chief crops are rice millet, wheat, barley, maize, cardamom, potatoes, oranges etc. Extensive and valuable forests abound. livestock includes cattle, Yaks, pigs, sheep and goats and poultry. Food industry and cement industries are the main industries.

**Nepal** is among the poorest and least developed countries in the world with nearly half of its population living below the poverty line. Agriculture is the main stay of the economy, providing a livelihood for over 80% of the and accounting for 41% of GDP (ADB, 2006). Textiles and carpet production is accounted for major foreign exchange earnings. Industry contributes about 22% of Nepal's GDP. Tourism is the second largest industry. In line with changes in the development aid strategy of donors, Nepal embarked upon a new economic policy regime in the mid 1980s. It has carried out various components of economic reform policies including fiscal, trade and FDI policies during the last decade. Quantitative restrictions on imports have been fully removed. Customs duties have been rationalized and substantially reduced. Reforms have also been executed on the foreign exchange front. However, political instability has stopped the reform process and the ambitions of the business community

**Sri Lanka** has liberalized economic policies in early eighties. In 1977, Sri Lanka became the first among all the South Asian economies to open up its economy to the outside world, and even to this day it remains one of the most outward oriented economies in the region. The economic reforms, from their inception, marked a sharp shift from a relatively closed economy prioritizing import substitution policies to a liberalized market and an export-oriented economy. Some of the major reforms were carried out in the areas
of: (i) liberalization of trade policy and exchange rate system; (ii) export promotion and incentives to investment, and (iii) the rationalization of public expenditure.

Maldives became independent in 1965, the land is in the south fed by the Niger and Senegal rivers supports the chief cash crops of peanuts and cotton subsistence crops of rice, millets, maize. Exports include fish from Niger and livestock. Extensive minerals resources are largely untapped. To some extent salt and gold are mined. Industries include textiles, food processing and cotton ginning.

All the seven countries started liberalizing their economies at different points in time in tandem with the global trend and the requirement of both the regions, these countries have also adopted liberal economic policies, which will be discussed in detail in later in this chapter.

**Economic Transformation**

An important aspect to look into is why do societies establish or create one or the other type of economic system? In economic terms, the economists try to explain this aspect by what they call the law of scarcity at any given point of time, there are insufficient goods and services to satisfy all human wants of the society. The societies tried to chose a system, which would work efficiently and exploit the resources in a best manner possible. It is convenient to classify economic systems into three types, Command economy, market economy and mixed economy. A different way of dealing with universal problem of scarcity, adopted by many ancient as well as contemporary societies, is by command economy. Where a central authority decides what goods will be produced, allocate human and physical resources at will in their production and determine distributive shares of the society. In a market system, all economic activities consists of engaging in exchanges, that is buying and selling factors of production and goods and services through the network of market places. Mixed economy is one in which some economic activities are decided by the command economy and some activities by the market economy.

About one third of the world population rejected market economy and launched an experiment constructing socialistic economic system during 1917 and 1950, which was based on the ideology of Marxism and Leninism. This system is known as the command economic system. This system was adopted by the Former Soviet Union and Mongolia.
and after World War II in Central and Eastern Europe, Baltic States, China, North Korea and Vietnam. History has shown many phases of successes and failures on the journey, whether it is from market economy to command economy or from command economy to market economy.

Transition was never easy, whether it’s from market economy to planned economy or from planned economy to market economy. In establishing a socialistic system, massive efforts were made to centrally control production of goods and allocate all resources through state planning. Now its failure has set in motion just as a radical transformation, as the transition economies change course, seeking to rebuild markets and reintegrate themselves into the world markets (World Bank Report, 1996). This transition process from planned economy to market economy involves a complex process of institutional structural and behavioral changes. Since independence, Central Asian countries started witnessing transformation from command economy to market economy.

**Transformation of Command Economy to Market Economy**

Transformation of a command economy to market economy was also a big challenge for these regions, because both the systems are contradictory to each other. Capitalism has been defined as an economic system in which productive assets are privately owned as goods are produced with hired labor for sale in the market to earn profit whereas in command economy most assets are publicly owned. This short definition describes the essence of these systems. (Gregory Grossman, 1967) Through the Fig 2.1, One could easily understand that how these systems are distinguished from each other.
Fig. 2.1
Model of the Socialist and Capitalist Systems

Model of the Socialist System

1. Undivided power of the Marxist-Leninist Party
2. Dominant position of state and quasi-state ownership
3. Preponderance of bureaucratic coordination
4. Soft budget constraint; weak responsiveness to price; plan bargaining; quantity drive
5. Chronic shortage economy; sellers' market; labor shortage; unemployment on the job

Model of the Capitalist System

2. Political power friendly to private property and the market
3. Dominant position of private property
4. Preponderance of market coordination
5. Hard budget constraint; strong responsiveness to price
6. No chronic shortage; buyers' market; chronic unemployment; fluctuations in the business cycle

Source: Janos Kornai, "What the change of System From Socialism to Capitalism Does and Does not Mean", Journal of Economic Perspectives, Vol. 14, No. 1,
These regions had to face an enormous challenge of liberalizing, privatizing and globalizing their respective economies. The key measures of reforms were macroeconomic stabilization, price and market liberalization, liberalization of exchange and trade system, privatization, establishing a competitive environment with few obstacles to market entry and exit and redefining the role of the state. It is important to state that the success of transition process depends not only upon the appropriate economic policies but also an availability of supporting political and legal economic institutions. The objective of stabilization is to reduce inflation either by reducing fiscal deficit or tightening monetary policy. Structural reforms on the contrary contribute to the growth in the long term, they aim at restructuring commercialization, privatization of state enterprises and enforcing on them financial discipline, External sector reform aim at diversifying trade, liberalizing prices and capital inflows\(^{17}\). (Gurgen, 1999) The table 2.1 describes elements of transition in detail.

**Elements of Transition**

**Table No. 2.1**

| 1. Fiscal Adjustment | (a) Reduce Fiscal Imbalances without recourse to Inflation Tax  
(b) Reduction of government payment arrears  
(c) Reduction of Quasi-fiscal operations by banks to public sector. |
|----------------------|--------------------------------------------------|
| 2. Stabilization     | (a) Reduction of inflation  
(b) Reducing fiscal and cement account deficits  
(c) Tightening of Monetary Policy  
(d) Central Bank independence |
| 3. Structure Reforms | (a) Price liberalization  
(b) Enterprise reform  
   Rehabilitation of State Enterprises  
   Enforcement of financial discipline on state Enterprises  
   Legal and Institutional Reforms  
   (c) Financial sector reforms  
   (d) Fiscal Reforms  
   Reforming Budget Process  
   Expenditure prioritization and tax administration reforms |
| 4. External sector reforms | (a) Liberalization of Foreign Trade Prices  
(b) Reform of Foreign Trade System  
(c) Market Diversification  
(d) Phasing out of Barter Trade  
(e) Currency Reform and Exchange Regimes  
(f) Liberalizing Capital Inflows  
(g) Allowing Foreign Direct Investment  
(h) Management of External Debt. |

The component of transition was generally classified having four major dimensions. Micro economics of transition, in which the focus was on creating market price signals through privatization. In macroeconomic of transition, the focus was on creating financial system, financial infrastructure and developing new role of state. It also includes new roles for International trade and finance, trading arrangements, movements to convertible currency. In addition to it also included provision of safety nets. In addition to other reforms the external sector reforms plays crucial role in the economic growth of any country. The question arises that how these reforms took place, gradually or by big bang policy?

Transformation Through Gradual Process or by Shock Therapy

Some transition economies adopted the “big bang or shock therapy” policy changes and some adopted the gradual policy changes. Shock therapy means very radical structural reforms, whereas gradual means slow change. (The first is to launch a rapid, all their program, undertaking as many as reforms as possible. The second is to change by way of partial and phased reforms) Table 2.2 explains all the reforms that under the big bang process, how quickly these reforms have been taken and under the gradual process how gradually these reforms implemented in a country’s economy.

Shock Therapy Vs Gradualism

Table No.2.2

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<thead>
<tr>
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<th>Shock Therapy</th>
<th>Gradual Approach</th>
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<tbody>
<tr>
<td>2. Privatization</td>
<td>Very quick e.g. voucher privatization</td>
<td>Commercialization and Corporatization may precede privatization, which is gradual e.g. Employee. Management buyout, ESOPs.</td>
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<tr>
<td>3. Target</td>
<td>Intended end point</td>
<td>Shaped by requirements of present needs</td>
</tr>
<tr>
<td>4. Institutional Knowledge</td>
<td>Institutions have no value in the end state. Hence rapid destruction</td>
<td>Old institutions are built on past knowledge, this should be processed during reform. Hence gradual replacement</td>
</tr>
<tr>
<td>5. Reversibility</td>
<td>Logic of end point target requires irreversibility</td>
<td>Policies are judged by performance reversible</td>
</tr>
<tr>
<td>6. Liberalization</td>
<td>Requires this as a first step to market economics</td>
<td>Slow liberalization accompanied by institutional building</td>
</tr>
<tr>
<td>7. Stabilization</td>
<td>Based on rigid monetarist polices. Quick disinflation</td>
<td>Exchange rate as an indicator for stabilization. No emphasis on quick disinflation</td>
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</table>

From the outset of transition, economists have been remarkably divided on the best strategy. There was never much doubt about what had to be done but the question was always, how these economies should proceed. Should they adopt gradual reform approach or they adopt the policy of Shock Therapy, whereas gradualism means a slow change and shock therapy means a rapid change of all policies.\(^{18}\) (Naray, 2001). While understanding all the economic policies, this study put emphasis on the external sector reforms due to its limitations.

**Trade as Generator of Growth**

Trade is an important generator of growth through attracting investors, who would be willing to explore resources from smaller markets to larger markets. The type of exports and imports classifies international transactions, which can be sorted out into two major categories: Current account transactions and capital account transactions. First include merchandise trade, Services and investments and second include sale and purchase of financial assets—stocks, bond and other financial assets. Trade means buying and selling of commodities within a nation or among the nations. Prof Jagdish Bhagwati elucidated free trade policy, “as absence of tariffs, quotas, exchange restrictions, taxes and subsidies on production factors used and consumption.”\(^{19}\) (Jhinghan, 2001). Liberalization of the foreign trade regime, including elimination of export controls and taxes, and substitution of low-to-moderate import duties for import quotas and high import tariffs and current account convertibility. Liberal economic policies could provide a comfortable environment to the investors. Those investors would help to explore resources from smaller markets to larger markets.

The developing countries had protectionist policies towards the rest of the world, of course, protectionist policies are harmful to developing countries, their own trade barriers also retard their development by creating disincentives to export. From an economics perspective, quotas are thought to be less economically efficient than tariffs which in turn are less economically efficient than free trade economic analysis. This has been explained in this diagram that how quotas impact on trade.
An import quota works by reducing the amount of foreign goods a country may import. In a competitive market, the equilibrium point which determines the price and quantity produced of a good is where the demand curve and the domestic supply curve intersect. In the case of a purely domestic market, this point is at $P^*$ and $Q^*$ (see Fig. 2.2). When international trade is introduced into the market, this equilibrium may change. Let us assume that the price of a certain good is less when imported from abroad than when produced domestically. We will also assume that the world economy can supply more goods at that price than could ever be consumed by the domestic economy. In this case, the international supply curve is a horizontal line at $P_2$, which is the price of that imported good. In this case, the equilibrium price lowers to $P_2$, and the equilibrium quantity produced increases from $Q^*$ to $Q_4$. Domestic producers will actually produce less ($Q_1$), while the balance (the difference between $Q_1$ and $Q_4$) will be supplied by imports.

When free international trade is introduced, consumers benefit significantly. In a purely domestic market, the consumer surplus is represented by the area A. With free international trade, this surplus increases to include B, C, D, E, F, G, H, and I because they only have to pay price $P_2$ for the good instead of the higher price $P^*$, and they are
able to purchase the quantity Q4 instead of the quantity Q*. On the other hand, domestic producers of the good are adversely affected. In a purely domestic market, the domestic producer surplus is represented by areas B, E, and J. With the introduction of free international trade, they lose areas B and E to consumers because they can only get the price P2 for their goods instead of the price P*. Finally, the economy on the whole benefits by areas C, D, F, G, H, and I, as these are areas of surplus that did not exist before the introduction of free trade. As is evident, all of the economic benefit goes to consumers.

Because of the adverse effects of free trade on domestic producers, those producers may attempt to petition the government to enact an import quota. When this happens, the government will restrict the quantity of a good that can be imported in order to increase the price and allow producers to recover some of their lost surplus. If the government restricts total imports to the difference between Q2 and Q3, three things will happen. First, producers will increase output from Q1 to Q2. Second, imports will decline from the difference between Q1 and Q4 to the difference between Q2 and Q3. Third, the price will rise to reflect the new total quantity consumed, which is now Q3.

The effect of an import quota on domestic producers is to allow them to recover the producer surplus in area E, which they take away from consumers. The effect on international producers is that they now obtain areas G and H as a surplus. The effect on consumers is that they lose E, F, G, H, and I. The effect on the total world economy is that areas F and I are lost in what is called a deadweight loss. F represents consumer surplus which is lost by goods consumed but not at a surplus to producers. I represents consumer surplus which is lost as these goods are not consumed at all. The effect on the domestic economy is that E is gained, but F, G, H, and I are lost. The following table summarizes the effect on the various stakeholders of an import quota. To summarize, free international trade represents the highest net benefit for consumers, the world economy, and the domestic economy. Purely domestic trade represents the least beneficial situation for domestic consumers, the world economy, and the domestic economy, but the most beneficial situation for domestic producers. An import quota is the most beneficial to foreign producers and somewhat beneficial to domestic producers, but is somewhat harmful overall to consumers, the world economy, and the domestic economy.
Other issues that deserve consideration are whether the international producers which obtain the quota rights are the most efficient producers or not. If they are not, this represents an additional deadweight loss to the world economy and a reduced benefit to those producers. Tariffs are generally seen as a more advantageous way to protect domestic producers without creating as much damage to the world economy as a whole. Economic theory and empirical studies suggest that import protection works as any government intervention in the price setting process— it distorts resource allocation and consumption decisions and is therefore generally welfare reducing. Tariffs raise the domestic price of imported goods and shelter domestic producers from international competition. Thus, import-substitution industries are helped while exporters and producers of non tradable are hindered. Therefore, protectionism affects the distribution of income as it always benefits some firms or sectors at the expense of the rest of society. Governments usually overestimate their ability to choose the right industry to protect and, over-time, are heavily influenced by special-interest politics rather than a consideration of national costs and benefits.

Since the break of the Former Soviet Union in 1991 the five Central Asian countries have been trying to move from previous autarchic dependencies towards greater openness in foreign economic relations. They are trying to integrate regionally as well as globally. The aim of this was to overcome the major weaknesses of the prior system so that appropriate strategies have been made for better understanding with the regions and the rest of the world. South Asian Countries has started liberalizing their economic policies early eighties and nineties. In some countries the reform process had started earlier than 1990s. Sri Lanka began its reform in 1977. However the Economic liberalization in Bangladesh and Pakistan, as in India gathered momentum only in the early 1990s. Central Asian countries started liberalizing their economies in 1990s since independence. These countries are going under the process of economic transformation. Liberalization has taken place in all sectors but this study will discuss and analyze the external sector reforms in Central Asia and South Asia in detail. The countries of these regions have had different abilities to overcome the challenges of economic liberalization. Initially these economies had to suffer a lot, because there was no single blue print of reforms available to countries in transition process, which involves institutional structural as well as behavioral changes.20 (Martha, De, Melo)
Economic Transformation in Central Asia

After Independence, Central Asian economies have gone through the systemic transformation from a command economy to a market economy. How can the government of Central Asian countries approach the array of reforms required in this transition phase? The command economy from which the Central Asian States emerged had already been partly dismantled under perestroika, particularly with respect to foreign trade. Despite having rich endowment of mineral resources, such as oil (Kazakhstan), natural gas (Turkmenistan and Uzbekistan), precious metal such as gold and tungsten (Kazakhstan, Uzbekistan, Kyrgyz republic) and thermal potential in (Kyrgyz Republic and Tajikistan), this region was one of the poorest and least developed in the FSU. Despite having full potential, these economies were characterized as low level of industrialization, large rural population, high population growth, authoritarian regime, internal and external threat and opposition of ethnic religious origin, a relatively high degree of poverty than in the former Soviet Union. These countries have succeeded in achieving macroeconomic stabilization and implementing market reforms. In these countries, including Kazakhstan, prudent fiscal and monetary policies have sharply reduced inflation. The past decade of transition has shown a deep crisis in the first half of the decade, with the most extreme case of Tajikistan, which was devastated by full scale civil war. During the large part Post independence decade the countries had to face high domestic inflation. High inflation caused disruption of investment pattern, changing consumer behavior, barter trade flourished and increased import bill. Main focus on the oil and gas sector and the other sectors have remained non-competitive. But some of them are rapidly recovering to achieve economic stability. (Gidadhubli, 1997) They have established legal framework for introducing economic reforms and looking forwards to policies to be implemented. Currently these economies are involved in the simultaneous tasks of state building, development and socio-political and economic restructuring, institutional building. (Kolkodo, Year) Some scholars described these reforms in a different way as Aslam and Banerji argued that there is stagnation in reform indicator related with the absence of the institutional reforms in the state. (Aslam and Benerjee) Ellman called these ‘mutant economies’ inefficient states even mafia-dominated markets. (Ellman, 2000). From elements of transition process as shown in figure 2 one can easily understand how difficult the transition process is. The economic conditions of the former Soviet Central Asian countries were not favorable for sustainable development strategy.
Spoor, 2000). Similarities in the economic situation: despite considerable differences in details, none of the Central Asian economies had a higher level of competition, and all the states find themselves at approximately the same stage of development. Moreover, these economies are looking for partners, who would exploit their natural resources and facilitate their entry into the global economy. The ultimate objective was to restore growth and improve the living condition of their populations. Even after independence, the Central Asian countries are finding difficult to put these resources into full exploitation. There is greater need to deal with the initial conditions of the Post soviet Central Asia. These were connected with historical, cultural, social demographic, geopolitical background. There were common features that originated from the Centrally Planned economy prevailed in the former Soviet Central Asia. It’s very important to understand the transition process of these economies.

The model of development has been very important for this region’s economic thought. Central Asian countries could take an example from the Chinese economic model how to gradually introduce reforms and successfully overcome all the challenges. The Chinese experience is shown in Box a. However, these countries need not necessarily limit to study the Chinese modal but other models also so as to adopt the best measures and policies offered by the various models.

**How Gradually China follows a Policy Of Socialistic Economic Development**

**Box a.**

China followed a policy of socialist economic development based primarily on the centrally directed allocation of resources through administrative means. By the late 1970s, this approach was increasingly recognized as being untenable and unsustainable, and an overhaul of the economic system was initiated. China’s approach to economic reform has been gradual and incremental, without any detailed “blueprint” guiding the process. This incremental approach is best depicted in a metaphor attributed to Deng Xiaoping as “crossing the river by feeling the stones under the feet” and is still applicable to many of the reforms being carried out by China today. The following features have characterized this incremental approach, First, reforms tend to be undertaken first on experimental basis in some localities before they are applied to the whole country. This minimizes disruptions to the economy, allows deficient policies to be modified based on experience, and provides time to build the necessary institutions for full implementation. Second, another strategy frequently employed has been the use of intermediate mechanisms to smooth the transition to a market-oriented economy. One example of this is the setting up of Special Economic Zones in the early 1980s as a way of gradually introducing foreign capital and technology. Finally, the Chinese leadership has consistently tried to preserve the socialist character of the economy while introducing market-oriented reforms. For example, even though policies have been conducive to the rapid growth of the non-state sector, state enterprise reform has been gradual with no signs of a mass privatization strategy for large and medium-sized enterprises as pursued by other transition economies.
In late 1980s and early 1990s, the development model debates were quite intensive during the first years of the post-Soviet development of Central Asia, partly because the Central Asian governments had attempted to start a new round of economic reforms. Actually, the followers of technocratic, Central Asian leaders had been trained in, and had experience of the Soviet command economy only and they had vague idea about market driven economies as well as deregulation of the state system. Kazakhstan's leaders turned out to be admirers of the so-called East Asian economic miracle—especially in South Korea and Japan. It was widely believed in Kazakhstan that it was possible to replicate the Korean economic miracle. Moreover, their first comprehensive perspectives strategy was rapid development in independent Kazakhstan. Kyrgyzstan's leaders also devoted themselves to the South Korean and Japanese economic models. What they called the Korean Model of economic development and decided to explore the opportunities for joint co-operation in developing Kyrgyzstan impressed Kyrgyz officials who visited South Korea in 1990. Uzbekistan's own road of renovation and progress has been always supplemented by a call to learn from the Chinese experience of gradual reforms. However, outside the country one of the most intensive discussions on Uzbekistan's model of development centered on the Turkish secular model and the Iranian theological model, because of the strong traditions of Islam in Uzbekistan. Thus, demonstrating the country's dedication to the modern and secular model of development was one of the most important tasks for Uzbekistan's foreign policy-makers. This model should have been attractive and acceptable to all people in the multicultural and multinational society in Central Asia. Central Asian Countries, especially in Kazakhstan and Kyrgyzstan, the ruling elite had to handle carefully nationalistic ideas in order to pacify the mood of their ethnic minorities. Also this model should have been powerful enough to meet the challenge of rising nationalistic and democratic expectations in society. Reference to Chinese and other Asian model of development has given the Central Asian Country's elites a rare opportunity to advocate preservation of strong state institutions, capable of promoting political and economic reforms. References to the experiences of China, South Korea and others helped the elite to justify their decision to maintain the regulatory role of the state, at least in the medium-term, and to delay radical economic changes. In 1991-1992, the Central Asian countries only partially accepted the
Russian concept of shock therapy, price liberalization and relaxation of state institutions' activities in economic affairs. However, very soon Turkmenistan and Uzbekistan chose their own way of development and endorsement of the Chinese way of gradual reforms justified their return to strict government control and to gradual economic changes. Kazakhstan initially followed the shock therapy approach. However, later on its government made serious corrections and revived some level of state intervention and control. Only Kyrgyzstan, which managed to overcome initial temptations to delay reforms, consistently carried out the recommendations of the World Bank and IMF and implemented shock therapy.

The different transition paths can be seen within the spectrum of five Central Asian countries. The forms of the transformation vary in this region, which would be characterized as wide scale reforms (Kyrgyz republic and Kazakhstan), non-reforms (Turkmenistan) towards gradual partial reforms (Uzbekistan, Tajikistan). Overall, the success of market oriented reforms has been mixed, according to various indicators developed by multilateral institutions Kazakhstan and Kyrgyzstan have progressed faster. Tajikistan has also made some progress. The level of reforms is low in Turkmenistan and Uzbekistan. However, Kazakhstan, Kyrgyzstan and Tajikistan have made significant progress in external sector reforms, but Uzbekistan and Turkmenistan’s low level of reforms in this sector has created some problems for regionalism. The table no. 1.6 shows the main key economic indicators and the status of reform in all the Central Asian countries. Table 2.3 explains that how these economies focused on economic policy and how much they successful in implementing these policies.

Key indicators and Reform Status of Central Asian Countries
Table No. 2.3

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP Per Capita, 2004 (in US dollars)</th>
<th>Population, 2004 (in million)</th>
<th>Share of World Oil</th>
<th>Share of World Gas</th>
<th>Geography</th>
<th>Reform Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Oil Exporters</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2,723.9</td>
<td>15.0</td>
<td>3.3</td>
<td>1.7</td>
<td>Landlocked</td>
<td>Active</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>1,250.7</td>
<td>6.2</td>
<td>0.042</td>
<td>1.6</td>
<td>Landlocked</td>
<td>No reforms</td>
</tr>
<tr>
<td><strong>Non-oil Exporters</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>432.4</td>
<td>5.1</td>
<td></td>
<td></td>
<td>Landlocked</td>
<td>Active</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>323.1</td>
<td>6.7</td>
<td></td>
<td></td>
<td>Landlocked</td>
<td>Active</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>461.2</td>
<td>26.0</td>
<td>0.05*</td>
<td>1.0</td>
<td>Double Landlocked</td>
<td>Partially active</td>
</tr>
</tbody>
</table>


#### Table No. 2.4

<table>
<thead>
<tr>
<th>Policy Type</th>
<th>Focus of Policy</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type I</strong></td>
<td>Macroeconomic-inflation, monetary and fiscal policies, and exchange rate Policy</td>
<td>These reforms did not achieve the anticipated increase in productivity in the CARs. One reason was that governments were unable to quickly create revenue flows to finance even recurrent expenditures, particularly those tied to state-owned enterprises (SOEs). As a result, there was a hesitation to replace inefficient SOEs with more efficient private enterprises, as removing subsidies frequently led to the failure of these SOEs. Banking reforms were successful in allowing entry although state banks, which retained their influence in many CARs. Social benefit systems were inadequate given limited resources. This overall situation did not improve until the late 1990s.</td>
</tr>
<tr>
<td></td>
<td>Microeconomic-labor market and wages, social safety nets, price liberalization (exceptions for energy, staple food, and housing) and removal of subsidies Banking and State-owned Enterprises-reduced subsidies, privatization, and bank liberalization.</td>
<td></td>
</tr>
<tr>
<td><strong>Type II</strong></td>
<td>Primarily legal policies:</td>
<td>Withstanding pressures from special interest groups was the main obstacle governments faced in trying to build a level playing field attractive to foreign investors. In the oil exporting CARs, for example, these policies proved successful in providing a reliable environment to attract foreign direct investment. For non-oil exporters, these reforms were less successful. Privatization did not bring expected benefits and special interest groups were able to influence policy.</td>
</tr>
<tr>
<td></td>
<td>. Developing legal and regulatory frameworks for industry and finance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>. Privatization of medium- and large-scale enterprises-sale of assets to employees or independent parties</td>
<td></td>
</tr>
<tr>
<td></td>
<td>. Restructuring the labor market-wage determination, unemployment compensation, and retirement benefits</td>
<td></td>
</tr>
<tr>
<td><strong>Type III</strong></td>
<td>Regional cooperation-within the CARs using various initiatives such as trade facilitation, transport, and energy policy dialogue and cooperation. Develop industrial competitiveness policies to foster diversification away from natural resources and other raw material production into manufacturing.</td>
<td>These policies were slow to develop, particularly in the first half of the 1990s when the CARs were more concerned with developing national identities and earning revenue through customs taxation. Recent developments, however, suggest a greater willingness to lower tariffs and cooperate on both transport and energy policies. To foster economic diversification, Kazakhstan introduced an innovative industrial development strategy in 2003, which contains elements of an industrial competitiveness policy agenda such as fostering industrial clusters. Azerbaijan is also assessing its industrial competitiveness and may follow suit.</td>
</tr>
</tbody>
</table>

Source: Malcolm Dowling and Ganeshan Wignaraja, Central Asia after fifteen years of transition: Growth, regional cooperation and policy choices in ADB working paper series on Regional Economic Integration no.3 at www.aric.adb.org, p.3.
Mixed response has been seen in these countries since independence. The countries of the Former Soviet Union had much more trade with each other than with the outside world before independence. The dependence of these countries on trade with each other was significantly high. So Central Asian Countries were part of a strongly integrated economy domestically, within the FSU, and rather closed externally. The disruption of administrative command system and the state monopoly of trade especially Council of Mutual Economic Assistance (CMEA), without the emergence of new market based mechanism. So with the other economic policies Central Asia also liberalizes their trade policies.

**Trade Liberalization Policies in Central Asia**

There is no doubt that foreign trade has been playing an important role in Central Asian Region. This region is highly economic dependence on external trade as comparable to other CIS countries. As a result these economies are also extremely vulnerable to external shocks. It has higher ratios of exports and imports in their GDP. The main challenges for these countries involve strengthening the capacity of broad, market based institutions, those which are more specifically more trade related, such as the financial sector, customs and trade, which would facilitate them to integrate into the World Trading System. Studies shows that effective integration includes country’s own economic policies specially trade policies and institutions, and of course their trading partner, which affect market access and the terms of trade. Progress towards trade liberalization has varied across the Central Asian region. Since independence External economic reforms occurred in five areas: trade liberalization, reform of trade system, from previous autarchic dependencies towards greater openness in foreign economic relations, market diversification, phasing out of barter trade and currency reforms. The major trade policy issue facing the global economy was the challenge of regionalism. Although during the Soviet period Central Asia acted as a singular unit but the economic condition of countries differ substantially at the time of disintegration.
Kazakhstan and Kyrgyzstan have been liberalizing their trade policy more or less steadily since their independence. Tajikistan liberalized its trade policy regime fairly rapidly after the end of civil war 1997. Turkmenistan has undertaken little trade liberalization. Uzbekistan liberalized its trade policy regime in 1990. But this has been partly reversed later on. The present status of these countries trade policy regime varies from a very liberal in Kyrgyzstan and Tajikistan to fairly liberal in Kazakhstan to quiet restrictive in Turkmenistan and Uzbekistan.

**Price liberalization**

The key trade development was the collapse of the Council of Mutual Economic Assistance (CMEA). Trade among the Soviet-bloc economies was planned and organized under the auspices of the CMEA, but in the International market buyer and sellers come from different countries to exchange goods and services. Prices play an important role. After dismantling of CMEA, first steps were taken towards price liberalization. All new states of Central Asia practically faced the consequences of almost full price liberalization. In October 1994, the government of Kazakhstan abolished almost all subsidies, keeping only few utility prices under control. Uzbekistan adopted a more gradual approach. Price control was largely phased out during 1992-1995. In Turkmenistan most prices have been kept under state control. In Tajikistan reforms were started in 1992 but interrupted by civil war and were resumed only after peace reconciliation in mid 1997. (Bakhtior, 2001, p.60.) The Uzbekistan tried to moderate the impact of full liberalization of prices and to complement the introduction of market mechanism with the traditional tools of economic governance had lower inflation at the initial stage 1992-1994. It suffered less negative effects compared with the radical reformers. Kyrgyzstan and Kazakhstan had also lower levels of non weighted average inflation within this stage of transition compared to other transition countries. It has been observed that the liberalization of prices without efficient financial institutions, which could provide fast, low cost and risk free money transactions even under high inflation certainly led to a barter trade. Price differentials emerged in Central Asian markets, due to different regulatory regime countries are not able to trade cross boarders. Turkmenistan and Uzbekistan are the countries with the regulated price, where trade potential has been converted into a shuttle trade. The Central Asian Countries could
considerably expand trade and diversify exports by reducing policy-related and institutional barriers to trade. They could cooperate with each other and their neighboring countries in improving their transport links with the rest of the world. For this they need to be open by reducing their tariffs etc.

**Tariffs, Non-tariffs, Subsidies, and Quota**

The Central Asian Countries had very similar trade policy regimes before their independence. But since independence, their regimes have diverged significantly. These countries were closely related to the former Soviet countries. Tariffs on imports create a bias against exports by raising the domestic price of imports relative to exports, or equivalently, by lowering the domestic price of exports relative to imports. Thus, import tariffs are equivalent to a tax on exports. Import tariffs also create a disincentive to export by increasing the cost of imported intermediate inputs used by export industries. For a given price of exports, a tariff on imported intermediate inputs effectively acts as a "cost penalty" on the production of exports. Duty drawback and similar schemes are designed to eliminate the bias against exports, but they can be difficult to administer. Empirical research has shown that the size of the export tax arising from import tariffs can be substantial. Tokarick (2006) studied 26 low-income countries and found that, on average, import tariffs in these countries were equivalent to about a $12\frac{1}{2}$ percent tax on their exports and 4 of these countries had export-tax equivalents between 26 and 34 percent.

These estimates do not take into account the disincentives that arise from other types of import barriers, namely nontariff barriers (NTBs). In economics, a **subsidy** is a kind of financial government assistance, such as a grant, tax break, or trade barrier, in order to encourage the production or purchase of a good. The term *subsidy* may also refer to assistance granted by others, such as individuals or non-government institutions, although this is more commonly described as charity.

**Non-Tariff Barriers to Trade**

These are restrictions to imports but are not in the usual form of a tariff. They are criticized as a means to evade free trade rules such as those of the WTO, the EU or NAFTA that restrict tariffs. Most common examples are antidumping measures and countervailing duties, which, although they are called "non-tariff" barriers, have the
effect of tariffs but are only imposed under certain conditions. Their use has risen sharply after the WTO rules led to a very significant reduction in tariff use.

Non-tariff barriers may also be in the form of manufacturing or production requirements of goods, such as how an animal is caught or a plant is grown, with an import ban imposed on products that don't meet the requirements. Examples are the European Union restrictions on genetically modified organisms or beef treated with growth hormones. Some non-tariff trade barriers are expressly permitted in very limited circumstances, when they are deemed necessary to protect health, safety, or sanitation, or to protect depletable natural resources.

Non-tariff barriers to trade can be: State subsidies, procurement, trading, ownership. National regulations on health, safety, employment. Product classification. Quota shares. Foreign Exchange: controls and multiplicity. Over elaborate or inadequate infrastructure. 'Buy national' policy. Intellectual property laws (patents and copyrights). Bribery and corruption. Unfair customs procedures. restrictive licences import bans seasonal import regimes so the actual bias against exports from all types of import barriers is likely larger. Developing countries typically have many “informal barriers” to trade as well, such as high levels of port and internal transportation charges that make it even more difficult for these countries to expand their exports. Reducing import tariffs, therefore, is an export-promotion strategy that countries can implement, regardless of whether their trading partners reduce their tariffs. Countries should be careful, however, as to how they design tariff reductions. In order to maximize the benefits, research shows that countries should reduce higher tariffs by more than lower ones and not exempt sectors from reductions. Critics say quotas often lead to corruption (bribes to get a quota allocation), smuggling (circumventing a quota), and higher prices for consumers.

In Kazakhstan, In the starting of 1992 the government began to apply tariffs and other measures to regulate foreign trade. The first law adopted by the Kazakhstani Parliament included status on tariffs principal of foreign trade, and inducement for foreign investment. In 1995 Kazakhstan reduced the list of goods subject to export quotas to minimum five items. The state policy had several negative characteristics: changes in exports and imports duties were frequent. The level of duties were high: imported goods were to an excise tax. In 1993, the new currency was established, which has enabled the country to conduct an independence economic policy. Kazakhstan: Kazakhstan has a
rather complex tariffs schedule (with 10 ad valorem and seven specific tariffs rates and some goods subject to both) but a relatively low non-weighted average rate. Excise taxes are imposed on both imported and domestically produced alcohol beverages and tobacco products. Kazakhstan also levies export taxes on limited number of goods when they are exported to the countries that are not members of EEC. Kazakhstan also apply quantitative restrictions, such as prohibition, quotas and licenses to the trade goods. Tariff rates are fairly low and uniform in Kyrgyzstan and Tajikistan. In Turkmenistan the tariffs ranging from 10 percent to 100 percent are applied to 94 commodities when they are imported by legal entities, imports by individual in amount up to $500 (as of August 2005) are exempted from tariffs. All countries apply quantitative restriction, such as prohibitions, quotas and license, to trade in goods that have implications for national security, public health and the environment. Turkmenistan and Uzbekistan restrict imports of certain products to protect domestic producers of these products. They also prohibit exports of some food products to ensure their availability in the domestic market at relatively low prices. The Table 2.5 assesses the simple mean tariffs and weighted mean tariffs in all the Central Asian countries. A major problem in all these countries is that changes in tariffs schedule have been frequent and unpredictable.

**Tariff Rates of Central Asian Countries**

<table>
<thead>
<tr>
<th>Central Asian Countries</th>
<th>1996</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Simple mean tariffs</td>
<td>10.0</td>
<td>8.4</td>
</tr>
<tr>
<td>Weighted mean tariffs</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>1995</td>
<td>2003</td>
</tr>
<tr>
<td>Simple mean tariffs</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Weighted mean tariffs</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tajikistan</td>
<td>2002</td>
<td></td>
</tr>
<tr>
<td>Simple mean tariffs</td>
<td></td>
<td>8.0</td>
</tr>
<tr>
<td>Weighted mean tariffs</td>
<td></td>
<td>7.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>1998</td>
<td>2002</td>
</tr>
<tr>
<td>Simple mean tariffs</td>
<td>0.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Weighted mean tariffs</td>
<td></td>
<td>2.9</td>
</tr>
</tbody>
</table>
Despite having formal tariffs low, there are many other policy instruments that Central Asian Countries use, often in a discretionary and non-transparent manner, to regulate trade. Lowering and rationalizing the non-tariff trade barriers as well as making those more transparent and less discretionary should be a major goal for regional cooperation.

### 3.3) Currency Convertibility

The establishment of new currencies. For the Central Asian governments at the moment of independence there were overwhelming advantages in the continued use of the Soviet rouble. The largest CIS economy outside Russia, Ukraine, broke away in 1992, but for the others a single rouble area was seen as a benefit to the maintenance (or restoration) of trade and payments relations within it; the newly-created central banks had no experience of monetary management, although the quarterly construction of 'the cash plan' by Union-Republican Ministries of Finance afforded a certain statistical expertise and network; and the EU’s Maastricht Agreement was perceived as a model for the inheritance of a common currency which should not needlessly be dismantled. In pursuit of those expectations a group within the CIS - Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Uzbekistan - meeting in Bishkek in October 1992 prepared for an Interstate Bank of the CIS, as had been delineated by a CIS Heads of State meeting in Tashkent the previous May. The IMF pointed out that those other banks had a reciprocal responsibility to establish uniform central bank lending rates and reserve requirements and to constrain their own credit issue, but monetary destabilization proceeded at widely disparate rates.

The Central Asian Countries have been divided into two groups with regard to their exchange rate policies. The unexpected collapse of the rouble zone in 1993 put the CARs' leaders in a difficult position and urged them to adopt radical steps towards currency reforms. Kazakhstan and Kyrgyzstan following the concept of radical 'shock therapy' accepted the conditions of Article VIII of the IMF charter rather fast on March 29, 1995 and July 16, 1996 respectively. New currencies like Tenge, Som and Somoni were introduced in Kazakhstan, Kyrgyzstan and Tajikistan. But it took two years in Kyrgyzstan and three years in Kazakhstan for the introduction of national currencies.
Exchange Rate policy

Following the introduction of domestic currencies the Central Asian States maintained the complex multiple exchange rate systems, complimented by the legislation that required exporters to repatriate export earning and surrender a portion to either the govt or central Bank. The ensuring multiple currency practices imposed an implicit tax or exports or subsidizing imports which benefited from a more appreciated exchange rate. (Multiple exchange rate practices also contributed to foreign exchange shortages by encouraging undervaluation of exports and diverting proceeds away from official Channels of conversion.) This promoted the rationing of foreign exchange by central Bank, which in turn fueled a parallel market activity. The Channeling of economic activity to the informal sector added to the tax collection problems and left some transactions entirely out side the tax base. One could say that Multiple exchange rate arrangements lacked transparency, distorted resource allocation and eroded budgetary tax revenue. 37 (Emine Gurgen, 1999. p.42.) The exchange rate regime in today’s international and monetary and financial system and the system unfavorable Foreign exchange and payment regulation in some Central Asian Countries creates additional hurdles. The Central banks used the foreign exchange obtained from exporters to purchase domestic currency at a more depreciated rate its always not transferred to the govt. More recently most of the Central Asian States have moved toward more flexible, unified and market oriented exchange rate regimes.

All the Central Asian states have chosen similar exchange rates regimes based on managed and floating systems of exchange auctions since the moment of their own currency introduction. These countries have been divided into two groups with regards to their exchange rate policies38. (Bakhtior, 2001.). The first group of countries such as Kazakhstan and Kyrgyzstan following the concept of radical shock therapy reforms accepted Article VIII status in IMF in 199639 have eliminated multiple currency practices.(Emine Gurgen, 1999. ) Tajikstan unified its exchange rate and abolished surrender requirements in April 1998. In second group of countries like Turkmenistan, restricted access to foreign exchange constitutes a major obstacle to imports while the requirement that certain categories of exporters surrender part of their foreign exchange earnings. Uzbekistan continues to maintain multiple exchange rates and surrender requirements.
Exchange rate of Central Asian Countries

Table no. 2.6

<table>
<thead>
<tr>
<th>Country</th>
<th>Tenge per SDR: End of the period</th>
<th>Tenge per US$: end of the year</th>
<th>Tenge Per US$: Average of the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Official rate</td>
<td>189.6 210.1 191.4</td>
<td>138.2 154.6 133.9</td>
<td>119.5 153.2 132.8</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>Som per SDR: End of the period</td>
<td>Som per US$: end of the year</td>
<td>Som Per US$: Average of the year</td>
</tr>
<tr>
<td>Official rate</td>
<td>62.3 62.6 59.0</td>
<td>45.4 46. 41.3</td>
<td>39 46.9 41</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>Somoni per SDR: End of the period</td>
<td>Somoni per US$: end of the year</td>
<td>Somoni Per US$: Average of the year</td>
</tr>
<tr>
<td>Official rate</td>
<td>1.9 4.0 4.5</td>
<td>1.4 3 3.1</td>
<td>1.2 2.7 3.1</td>
</tr>
</tbody>
</table>

Box.b

Main Definitions used in the Analysis of Trade Taxes

**Harmonized System**: An International classification developed by the World customs Organization, which is arranged in six digit codes allowing all participating countries to classify traded goods on a common basis. Beyond the six digit level, countries are free to introduced national distinctions for tariffs and many other purposes.

**Tariffs**: Custom duties on merchandise imports levied either on an ad-valorem basis (percentage of value) or on a specific basis. Tariff give price advantage to similar locally produced goods and raised revenues for the government.

**Ad-Valorem Tariff**: An import duty with a tariff rate charged as the percentage of the price.

**Specific Tariffs**: An import duty with a tariff rate charged as affixed amount per quantity.

**Compound Tariffs**: A combination of advalorem and specific tariffs.

**Mixed Tariffs**: A choice between advalorem and specific tariff depending on the conditions attached.

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

**Tariff peaks**: Relatively high tariffs, usually on sensitive products. Tariffs of 15% and above are generally recognized as international tariffs peaks. Tariffs at least three times than the members overall simple average are recognized as domestic peaks.

**Duty Drawbacks**: providing rebates t exporters for the tariff duty paid on imported intermediate inputs.

**Most Favored Nation**: Most favored nation treatment (GATT Article I, GATT Article II, and TRIPSArticle IV), the principle of not discriminating between one’s trading partner.

Import Taxes in Central Asian countries

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

Assessing the level of import tariff protection is further complicated by the complex tariff system in place in Central Asian countries. Many CAREC countries have shifted their tariffs to the ad valorem methodology under the WTO Harmonized System of classification of trade goods. At the same time, combined and mixed tariffs are still widespread in these countries. Kazakhstan, the Kyrgyz Republic, Tajikistan and Uzbekistan apply specific tariffs expressed in EUR, U.S. dollars, or national currency to a volume of some imports expressed in a specific unit (liter, ton, units, etc). Some countries (e.g., Kazakhstan and Uzbekistan) use compound tariffs for some goods applying specific tariffs simultaneously with ad valorem tariffs. Therefore, assessing the overall level of tariffs is complicated by the need to convert these specific and combined tariffs to ad valorem for comparability.

Export Taxes

The rational behind taxing exports is broadly to raise revenue in case of exploitation of natural resources, to Support domestic industry by ensuring lower prices on raw material inputs, substitute for income tax and compensate for the costs of the customs procedures.

Trade Taxes are very complex and difficult to enforce in some Central Asian countries. Import tariffs are relatively low in all Central Asian countries but the trade taxes regimes are very complex.

Economic Liberalization in South Asia

It is evident that all the five south Asian countries, i.e., India, Pakistan, Bangladesh, Sri Lanka and Nepal, have been consistently following economic reform policies emphasizing the market economy and integrating their economies with the rest of the world. Bangladesh, Sri Lanka and Nepal also had higher GDP growth rates in the nineties
than the eighties. While the higher growth in India during 1991-2002 was accompanied by substantial growth in the service sector and a marginal improvement of the agricultural sector, the growth in Bangladesh, Sri Lanka and Nepal was supported by both higher industrial and service sector growth. But, GDP growth rate in Pakistan slowed down substantially during the nineties compared to the eighties due to internal conflict, political instability, social insecurity, and the interrupted business climate. Per capita income growth also slowed down in Pakistan during the nineties, whereas it improved in India, Bangladesh, Sri Lanka and Nepal. Other important macro indicators like gross domestic savings and gross domestic capital formation improved in all these countries except Pakistan. Following economic reforms, particularly trade reforms in these countries during the nineties, export and import growth has substantially improved. Further, India, Bangladesh, Sri Lanka and Nepal have improved considerably on the external sector front such as the current account balance, capital account, foreign exchange reserves and overall improvement in balance of payments during the post-reform period. There has also been an improvement in most of the macro indicators except the fiscal deficit, both on the domestic and external sector front. Indeed, the South Asian region has been one of the fastest growing regions in the world in recent years. The above analysis suggests that with the exception of Pakistan, the South Asian countries have registered higher export growth during the nineties than the eighties.( Pravakar Sahoo, 2006 ) Though Pakistan failed to accelerate its exports growth in the 1990s, it has managed to maintain a constant rise of exports in absolute value. South Asian economy on the other hand comprises traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, wide range of technological industries and large number of services. The region has been characterized as a region of large economic and social disparities. South Asia is a region of 1.4 billion people including forty percent of world’s population living below poverty line (2004). The region has world’s highest illiteracy rate at forty five percent. These economies are in the vicious circle of low- per capita income growth, high population growth and political instability. Despite that growth rate has remained positive in the region. South Asia GDP growth rate was 7.0 percent in 2003 and remained 7.1 percent in 2004. This region is among one of the fastest growing region of the world with the five percent average economic growth for the last one decade. Almost All the
South Asian countries have discarded the import substitution policy as a failed strategy. Orientation towards economic liberalization and greater reliance on the private sector development is now deeply rooted in almost all these countries⁴². (ADB, 2004) To make it more convenient for the private sector All the govts of South Asian countries started liberalizing their trade policies.

**Trade liberalization policies in South Asia**

During the last decade, South Asia’s five largest countries - India, Pakistan, Sri Lanka, Bangladesh and Nepal - have been implementing trade policy reforms, gradually moving their economies away from protectionism toward greater trade openness and global economic integration. Sri Lanka had started liberalization process in the late 1970s and the four mainland countries began to follow the liberalizing course in the late 1980s and early 1990s. All the other countries in the region have initiated major policy reforms with respect to the external sector which, included reduction in the level and dispersion of tariffs and quantitative restrictions and removing regulations on foreign investments. Trade liberalization in India moved ahead in a major way with the removal of most remaining Quantitative Restrictions, but it stalled and went backwards in some other respects. However, the liberalizing momentum resumed with large cuts in industrial tariffs between 2002 and February 2004. In Bangladesh, the mid-1990s some aspects of trade policy reform continued, although more slowly, but in other respects import policies steadily became more selective and protective until this trend was reversed to some extent in Bangladesh’s 2004-05 budget. Pakistan’s comprehensive liberalization of its trade policies since 1996-97 including its agricultural trade policies, and Sri Lanka’s potential to resume long-deferred reform as prospects improve of ending its civil war - contribute to a regional picture of very mixed achievement but widely shared opportunity. The South Asian countries missed the tide that carried many of their East and Southeast Asian neighbors to record rates of growth and poverty reduction during the 1960s and 1970s, but their later trade policy and other liberalizing reforms came in time to for them to benefit from the expansion of production and trade in the world economy during the 1990s. They now have an opportunity to undertake a third phase of reform in which they could further lower their barriers against trade-by general developing
standards still very high in Indian and Bangladesh and further strengthen their economies’ performance through international commerce and competition. Each country faces differing opportunities to exploit and resistances to overcome. Because many of their circumstances and choices are similar, however, this study seeks to assess their situations collectively as well as separately. Many of its findings are broadly applicable. So, with allowances for historic, economic and social differences, are many of its policy recommendations.

There have been significant reform measures with respect to the domestic sectors of the economy like the industrial de-licensing to do away with entry barriers, reforms in agricultural prices, removal of subsidies and fiscal consolidation. The early years of the new millennium witnessed further initiatives to consolidate the efforts made during the last decade.

**Tariffs, Non-Tariffs, Subsidies, and Quota**

The 1990 witnessed comprehensive reform process in All the South Asian Countries. With the exception of Sri Lanka which began opening trade and capital flow in 1977. All countries initiated major policies related to external sector including reduction of tariffs and quantitative reductions and removing regulations on foreign investments. 43 (SA annual report, 2004,)

**India**, trade liberalization that started during 1991-92 continued for about five years during the 1990s, but lost momentum in some key respects between 1997 and 2001. Under outside pressures which originated in the Uruguay Round, the large number of QRs that India retained to protect consumer good producers were phased out during this period. On the other hand, many industrial import tariffs rose, antidumping became a major activity, specific duties were imposed to protect the textile and garment industry, local content arrangements were used in the auto industry, and towards the end of the period especially, tariffs protecting major agricultural products and agro-industries were substantially increased. Import weighted tariffs in India has fallen from 87 percent in 1990-91 to 20.3 percent in 1997-1998. The maximum tariff during this period was 35 percent because for few products it exceeds this limit. 44 (Srinivasan, 2001)

Substantial tariff reform resumed, however, with the reduction of the general maximum customs duty from 35 percent to 30 percent in the 2002-03 budget, to 25 percent in the
2003-04 budget, and to 20 percent on January 8, 2004, when another protective import tax (the Special Additional Duty) was also abolished. But agriculture was excluded from this new liberalizing initiative: state trading import monopolies are being maintained over the major foodgrains, and agricultural tariffs have been going up even as the average level of industrial tariffs has been declining. India’s unweighted average agricultural tariff in February 2004 (including tariffs on processed foods) exceeded the latest available estimates of average agricultural tariffs in all but three (Turkey, South Korea and Morocco) of 124 developed and developing countries.

Pakistan, trade liberalization which started in the 1980s continued slowly but without serious interruptions until 1996/97. A new, comprehensive trade liberalization program commenced in that year and continued until 2002/03, when the general maximum customs duty was reduced to 25%. Actual protection rates are a bit higher then customs duties, however, owing to differences in the incidence of an income withholding tax which is applied to imports and domestic transactions. No major changes to tariffs were made in the 2003/04 budget, and there are no officially announced plans for further reductions in industrial tariffs. On the other hand, the government has largely completed an ambitious and politically sensitive program of comprehensive liberalization of the trade and other policies that affect its agricultural sector. This contrasts with India, Bangladesh and Sri Lanka, where there are strong protectionist elements in agricultural policies. One factor influencing trade policy liberalization in Pakistan is the recognition of the large volumes of illegal imports via Afghanistan and from India that high protection has encouraged.

Bangladesh has a very large export-oriented garment industry established in the 1980s, which has grown rapidly during the 1990s to the present. However, many of the manufacturing industries supplying the domestic market are still heavily protected: tariffs (including the effects of protective import taxes on top of customs duties) of 50 to over 100 percent are common. In Bangladesh maximum tariff rates has been slashed from 300 percent in 1992-1993 to 37.5 percent in 1999-2000. customs duties were reduced, but these reductions were offset by the use of a variety of other protective import taxes. By 2000-01 these tariffs accounted for more than one-third of Customs collections from protective import taxes. Bangladesh has also progressively eliminated the QRs on imports.
and reduced the number of banned items. Only 2 percent of the items are subject to QRs. The products that are either banned or restricted account for only 11.7 percent of tariff lines during this period. The 2002/03 budget reduced the basic maximum customs duty and abolished one of the tariffs, and there was a further reduction in the basic maximum Customs duty in the 2003-04 budget, but increases in the other tariffs more than offset this reduction. In early 2004, as measured by its average unweighted protective import taxes. The average tariffs on capital good, intermediate goods and consumer goods are very low. But Bangladesh was the most protected of the South Asian economies, with especially high tariffs and other taxes in agriculture. However, the extent to which these measures actually enable local firms to increase their prices is uncertain, owing to the large volumes of illegal imports, especially from India. The illegal imports include conventional smuggling across the border that by-passes customs posts, but a larger volume is generally considered to be “official” smuggling which comes through both the port and land customs posts, involving under-invoicing and other without declarations, despite the operations of pre-shipment inspection organizations.

*Sri Lanka’s* trade and its industrial sector are dominated by its export-oriented garment industry and its textile sector. Despite the addition of a surcharge to Customs duties, industrial tariffs are low, and in 1997 all textile tariffs were abolished and since then the textile industry has been operating under freetrade conditions, both in supplying garment exporters and the domestic market. However, there is significant protection of some manufacturing industries, and also considerable intervention and protection of some major agricultural import substitution crops, especially rice, potatoes, onions and chilies. Sri Lanka’s early trade liberalization and the appreciation of its currency in relation to the Indian Rupee led to a large and growing trade deficit with India, and in the hope of correcting this deficit, Sri Lanka entered into a free trade agreement with India which became operative in March 2000. Although Sri Lankan exports to India have increased quite rapidly since then, up to 2002/03 they were still very small, and the bilateral trade deficit with India had increased substantially. Sri Lanka provides incentives to the exporters including easy financing, unrestricted and duty free excess to imported inputs, and official assistance in identifying export markets. In addition to these incentives
companies that export 90 percent of their output and use advanced technology in manufacturing are allowed to tax exemption on profits and dividends for five years.\textsuperscript{46} 

\textit{Nepal} has generally low, but some moderate and a few high industrial tariffs. Agricultural trade is quite open with low tariffs. Under its trade treaty with India, Nepal gives generally rather small preferences to imports from India, but most of its exports to India are duty free, although subject to quite restrictive rules of origin and other barriers. Of the very substantial illegal trade with India, some of which bypasses Customs posts, a large portion is under-invoiced, misclassified, or otherwise unrecorded at Customs. Because Nepal’s tariffs are generally much lower than India’s, India is highly sensitive to Nepal’s trade policies and periodically imposes special tariffs or other restrictions. This happened in early 2002 when India imposed tariff rate quotas on Nepalese exports to India of vegetable ghee (hydrogenated palm oil) and copper wire and rods and imposed anti-dumping duties on acylic yams. These measures caused considerable disruption in Nepal. In 2002, in order to finance the conflict with the Maoist guerilla movement, the Nepalese government added a “security tax” to its Customs tariffs but not to domestic transactions, thereby increasing tariff protection for local industries. At least while the conflict continues, it seems unlikely that Nepal will reduce tariffs or otherwise liberalize its trade policies.

\textit{Bhutan} About 80 percent of Bhutan’s merchandise trade is with India, approximately three quarters of its imports and 95 percent of its exports. In addition, its hydro-electricity exports, which are the principal driving force in its economy, are entirely to India. India’s dominance in Bhutan’s trade is a natural outcome of its location, but is reinforced by a free trade agreement under which Bhutan’s exports are exempt from Indian tariffs, and Bhutanese imports from India are exempt from Bhutan’s import licensing and from tariffs. For a tiny economy, some of Bhutan’s tariffs are rather high, and protection is further increased by a sales tax which is applied to imports but not to the production of local import substitution firms. These arrangements appear to be economically inefficient in some ways, by diverting imports from third countries to higher cost suppliers in India, and by providing excessive protection to local import substitution production. On the other hand, the FTA may benefit some Bhutanese exporters by giving them duty free access to protected markets in India. 

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Maldives' Foreign exchange earnings in the Maldives are predominantly from tourism and fish exports. Customs duties on imports provide about two-thirds of government tax revenue, as there are no other indirect taxes. For a very small economy, tariffs are quite high, averaging about 21 percent, and even though there is no local production of most imported goods, they have the potential to shelter pockets of high cost local production and to distort resource allocation away from economically more efficient activities, especially export related activities. In the past a number of imported products were subject to QRs, but most of these were removed quite recently in 1998. However, as of December 2002, import quotas, most of which were allocated to a parastatal (the State Trading Organization), were still being used to regulate imports of rice, sugar and wheat flour. About a fifth of Maldives trade (mainly imports) is with South Asia, about 13 percent with Sri Lanka and 8 percent with India: trade with Pakistan, Bangladesh, Nepal and Bhutan is zero or negligible.

**Exchange Rate policy**

One broader area of notable advance which has facilitated trade policy reforms, in the region, is the move towards more market-based exchange-rate regimes. India, Pakistan, and Sri Lanka now maintain floating exchange rates; Bangladesh, which had a moderately flexible exchange rate system after 1991, floated its currency as of May 2003. Maldives's currency is pegged to the US dollar, and periodically devalued. Nepal's and Bhutan's currencies are pegged to the Indian rupee. Floating or flexibly managed exchange rates have been important supports for the trade liberalizations that have occurred in the region, by offsetting or partially offsetting the effects of QR removal and tariff cuts on import competition for domestic industries, and by increasing the domestic currency prices received by export industries. Because of their fixed exchange rates with the Indian Rupee, for Nepal and Bhutan, these effects have been partial and indirect and have not affected their trade with India. More generally, unlike the other South Asian countries, they are not able to use the exchange rate as a means of adjusting to terms-of-trade and more general macro-economic changes. The massive devaluation of the Indian Rupee between 1985 and 1992 (in real terms almost 150% as measured by its Real Effective Exchange Rate index, or REER) facilitated India's initial slow trade liberalization during the late 1980s, and made its much more sweeping post 1991 import
liberalization program on the whole quite painless. Because Nepal’s currency is tied to
the Indian Rupee, the same Indian devaluation also supported the major liberalization of
Nepal’s import policies that was implemented in the early 1990s. Pakistan’s REER was
devaluated at a steady rate between the mid-1980s and 1992, stabilized at or slightly below
this level until mid 1998, and then was devalued rather sharply until late 2001, after
which it strengthened somewhat. The continuing real devaluation trend was in part a
consequence of, but has also facilitated, trade liberalization, especially the new program
that commenced in 1997. Bangladesh’s REER has been remarkably stable for over 20
years. The strength of the Taka is in part due to the rapid growth of ready-made garment
exports and increasing remittances from Bangladesh workers outside the country.
Together, these more than offset aid inflows which declined relative to GDP, and were
sufficient to balance whatever increases in imports resulted from the trade liberalization
measures that were implemented during the late 1980s and early 1990s. An important
reason for the relative stability of the Sri Lankan Rupee has been the rapid and sustained
expansion of garment exports and tourism receipts. In Sri Lanka as in the other South
Asian countries, in recent years flexibly managed or floating exchange rates have
replaced the periodic official use of multiple exchange rates in the past, and largely
eliminated black market premier, both of which used to be a source of distortions and rent
selling behavior that complicated the administration of import and export policies.
The Indian devaluation up to 1992 was more than sufficient to sustain the pre-announced
tariff reduction program that continued into the 1990s, and from 1992 to the present
India’s REER index has remained at about the same level, reflecting nominal exchange
rate changes that have approximately offset but not exceeded India’s inflation rate
relative to the inflation rates of its principal trading partner countries. However the initial
devaluations were much larger than the devaluations that occurred in Pakistan,
Bangladesh and Sri Lanka, with the result that the Indian Rupee became much cheaper
relative to their currencies in real terms. This has helped spur Indian regional exports,
both recorded exports and unrecorded informal exports, especially to Bangladesh and Sri
Lanka, while its more difficult for these countries to export to India. This expansion of
Indian exports to the region represents a correction of many earlier years during which
exports which would otherwise have occurred were constrained by import barriers in the
other South Asian countries, and by the substantial overvaluation of the Indian Rupee, which was in turn a consequence of its own highly restrictive import policies. The resulting bilateral trade deficits and increased competition for domestic industries have affected regional trade policies, with resistance to the expansion of tariff preferences for India in Bangladesh, and by contrast a Sri Lankan initiative which culminated in 2000 in a free trade agreement with India. In Sri Lanka, the free trade agreement was perceived as having relatively low trade diversion costs on the import side owing to Sri Lanka’s generally low tariffs, and substantial potential benefits on the export side, provided India was willing to offer tariff exemptions for products which Sri Lankan exporters can supply and which are still subject to high MFN tariffs in India. In Bangladesh, on the other hand, tariffs and therefore the probable trade diversion costs of preferential Indian imports are high, as would be the competitive impact on local industries, while there is much pessimism about the prospects of Bangladeshi exporters succeeding in the Indian market, even with duty free access. Following the Asian financial crisis of 1997, the exchange rates of a number of the East and South East Asian countries, including South Korea, Indonesia, Thailand, and Malaysia were sharply devalued in real terms in relation to the South Asian currencies. This increased competition for South Asian exports and slowed down their growth, and at the same time sharpened import competition. With the notable exception of Pakistan, this increase in import competition was an important factor in the slowing of the general momentum of import liberalization in the South Asia region, and its reversal in some respects in India and Bangladesh between 1997 and 2002. The resumption of trade liberalization in India and Sri Lanka during 2002, in part reflected improvements in their balance of payments situations, which in turn are linked to a pick-up in the growth of manufactured exports, in India the rapid expansion of software exports, and increased capital inflows. Consequently, in contrast to the earlier trade liberalizations, real exchange rates have so far not weakened significantly and in the case of India have strengthened to some extent. As a result, the effects of reforms such as tariff reductions on import competing activities are presently not being cushioned by exchange rate devaluation, which in turn has meant that they are politically more difficult to manage, with pressures to make exceptions for firms or industries which are able to lobby effectively, or to obtain special treatment in various ways e.g. through tariff increases,
tariff reductions for intermediate inputs, anti-dumping in India, or through the proper implementation of these policies. This table 2.7 shows how Rupees float at the market rate with the US $.

**Exchange Rates of South Asia**

**Table No.2.7**

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>Bangladesh</th>
<th>Pakistan</th>
<th>Srilanka</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rupees per SDR: End</td>
<td>Taka per SDR: End of</td>
<td>Rupees per US$: end of the year</td>
<td>Rupees Per US$: Average of the year</td>
</tr>
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<td></td>
<td>of the period</td>
<td>the period</td>
<td>the year</td>
<td>the year</td>
</tr>
<tr>
<td></td>
<td>Market rate</td>
<td>Market rate</td>
<td>Market Rate</td>
<td></td>
</tr>
<tr>
<td></td>
<td>59.6 65.2 64.1</td>
<td>69.9 78.7 94.6</td>
<td>71.0 79.5 85.5</td>
<td>75</td>
</tr>
<tr>
<td></td>
<td>Rupees per US$: end</td>
<td>Taka per US$: end</td>
<td>Rupees Per US$: Average of the year</td>
<td></td>
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<td></td>
<td>of the year</td>
<td>of the year</td>
<td>of the year</td>
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<tr>
<td></td>
<td>Average of the year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>43.0 48.6 44.1</td>
<td></td>
<td>49.0 57.8 64.3</td>
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</tbody>
</table>
### Principle Measures of Trade Policy Since Liberalization

**Table no.2.8 Import Policies**

<table>
<thead>
<tr>
<th>Policy objectives</th>
<th>India</th>
<th>Bangladesh</th>
<th>Nepal</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>Maldives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximising the benefits from expanding global market opportunities</td>
<td>Reduction of tariffs</td>
<td>Elimination of quantitative restrictions on imports</td>
<td>Enhancing contribution of trade sector to the national economy by promoting international trade.</td>
<td>Rationalisation of the tariff structure Reduction of non-tariff barriers Simplification of import procedures.</td>
<td>Tariff reductions Harmonisation of Tariff structure Tarification of Quantitative Reductions</td>
<td></td>
</tr>
<tr>
<td>Import Licencing</td>
<td>Licencing requirements dismantled for about a third of consumer goods 340 items have been removed from negative list.</td>
<td>A few Quantitative restricted products are subject to import licencing.</td>
<td>Restricted list has been abolished Licencing requirements for outside the negative list have been removed.</td>
<td>Licencing required only for some agricultural products A few items requiring licence for health or religious reason</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banned items</td>
<td>As of April 1998 import of 58 items were completely prohibited 2714 items were on the restricted list and 168 importable canalized.</td>
<td>11.7% items subjects to import ban on restrictions</td>
<td>QRs removed on a wide range of products.</td>
<td>As of 1999, only 28 items banned for religious health and security and reasons</td>
<td>Import of reserved items restricted to government or state corporation</td>
<td></td>
</tr>
<tr>
<td>Quantitative restrictions</td>
<td>QRs on 714 tariffs lines have been removed</td>
<td>QRs have been progressively removed. At 8-digit HS level only 2% of items are subject to Quantitative restrictions.</td>
<td>QRs removed on a wide range of products Products subjects to QRs firearms wireless transmitters and precious metals and Jewellery.</td>
<td>In 1999, only 32 products on negative list.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*As of April 1998 2714 items were on the restricted list and 168 importable canalized. 11.7% items subjects to import ban on restrictions.*
Export Policies

<table>
<thead>
<tr>
<th>Export promotion Zones</th>
<th>India</th>
<th>Bangladesh</th>
<th>Nepal</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
<th>Maldives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial units located in special economic zones are treated outside custom territory of the country, not subject to any predetermined conditions on value addition, export performance, or local content.</td>
<td>Export processing zones set up in Dhaka and Chittagong. Private export processing zones allowed in 1996.</td>
<td>Export processing zones established in Karachi and Lahore. These zones offer better infrastructure facilities as well as various other incentives including tax holidays, and unrestricted reparation of capital and profits.</td>
<td>Free exports of all goods allowed, except for some items subject to certain restrictions.</td>
<td>No export controls except on products in the categories of coral chunk and shells, wood and articles of wood, ivory, and antiquities.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Duty Drawback | The facility reimburses exporters for tariffs paid on imported raw materials and intermediates and for central excise duties paid on domestically produced inputs. | Exports are entitled to duty drawback facilities. | Exporters are allowed rebates on custom duty, sales tax, and surcharge. Rates are standardized as percentage of f.o.b value of exports or specific amount per unit of exports. | |

| Duty Free Export | Free exports of all goods allowed, except for some items subject to certain restrictions. Replenishment licenses allow exporters to import certain raw materials that are normally banned or restricted. | All products other than banned ones or those under QRs can be exported freely. | |

Central Asian and South Asian countries integration into the world economy

The major challenges facing the Central Asian Countries concern transportation of oil and energy resources to the world markets. Before Independence of these countries, transportation of these resources was carried by pipeline through Russia. Russia has imposed strict quota on the passage of oil through Russian pipelines. Land locked location and harsh condition make to and from central Asia more expensive. Undoubtedly the economic leader was Kazakhstan, contributing almost half the region's GDP in 1991. Uzbekistan was enjoying one-third of the regional GDP, and the remaining portion was split almost evenly among the other three republics. The scale of the Central
Asian economies was not sufficient. Central Asia was responsible for 0.4 percent of the world GDP in 1991, but comprised 0.97 percent of the world population. Kazakhstan is the regional leader in natural resources and minerals. Its raw material base includes the widest range of minerals in the region fuel, ores, non-metals and is already mining a relatively high volume of minerals at the present time. The mineral base of other Central Asian states includes gas and gold in Uzbekistan, gas in Turkmenistan, and uranium in Kyrgyzstan and Tajikistan. Central Asia was the least urbanized region in the former Soviet Union. According to the 1989 Census, the level of urbanization fluctuated in these countries from 31 percent in Tajikistan to 57 percent in Kazakhstan. These figures are partly misleading, since a significant portion of the nominal "cities" are really large villages and regional centers in which the environment, culture and way of life are far from "urban." However, the level of urbanization of the native populations of these regions is actually lower than the official figures. The percentage of city-dwellers among Russians fluctuates from 70 percent in Kyrgyzstan and 77 percent in Kazakhstan, to nearly 100 percent in Tajikistan, Uzbekistan and Turkmenistan, and the percentage of city-dwellers among the indigenous population’s range from 20.5 percent to 38.5 percent.

SAARC economic integration process is often viewed with skepticism and perceived as one perpetuating the asymmetries further in a number of key countries such as Bangladesh and Pakistan but sometimes also in Nepal and even Sri Lanka. These apprehensions have affected the pace of regional economic integration in South Asia. Therefore, there is need for a better understanding among the people of the region about the gains from the regional economic integration and opportunity cost of non-cooperation. Against that background, the proposed project will quantify the gains from regional economic integration for the region and for each of the participant country. This will be accompanied by identification of other benefits of regional economic integration such as its potential in facilitating intra-regional FDI flows and building supply capabilities and the pros and cons of regional versus bilateral approaches. The study will also provide a way forward to the region for optimizing the gains from regional economic integration. The findings will be disseminated among the policy makers and other opinion makers through Policy Workshops, RIS South Asia Development and
Cooperation Reports and Policy Briefs and newspaper columns. It will be conducted in collaboration with researchers from institutions in different SAARC countries. RIS is currently discussing the proposal with ADB for possible funding. It is expected to be launched in late 2004 and will have an eighteen months time frame.

The South Asian economies are reorienting their policies according to the increasing role of globalization and privatization in the changing international economic scenario. Economic liberalization in South Asian region characterized as reform measures in the following areas: privatization of state enterprises, reduction of subsidies to the industries, liberalization of capital market and trade. Production trade and investment reforms implemented during the past two decades have provided new opportunities and generated faster economic growth. Trade liberalization has been an important aspect of economic reforms in late eighties and early nineties. Unlike the other transitional Asian countries, this region has generally avoided financial problems. Sufficient flow of Foreign Direct Investment in this region revived the confidence in economic perspective. Macroeconomic conditions in the region are fairly strong. But the progress among the seven South Asian countries varies. The common theme between two regions is that regional economic integration has become an integral part of their liberalizing economies.

South Asia is full of rivers mountains and large glaciers ands an abundance of sunshine which can be harnessed to produce power for life and industry. The economies in South Asia continue to prosperous. Regional Gross domestic products in this region update at 6.8% for 2005 and 6.6% in 2006 or it might be slightly better than that. Factor behind this is that India and Pakistan are running very successfully. The region as a whole benefiting from its further integration into an expanding global economy. Both the economies are rising consumer spending, generally accommodating monetary policies and continuing market liberalization policies that faster business activities and investment.
**End Notes**


10. Ibid.p.36


15. Ibid.


20 Martha De Melo, Cavdet Denier and Alan Gelb, “Pattern of Transition from plan to market” The World Economic Review, Vol. 10, No. 3, pp. 397-424


22 R.G. Gidadhubli, "India's Economic ties with the Central Asian States- Need for more Productive Engagement", paper presented on India-Central Asia conference, 16-18 December at New Delhi, p. 2


27 ethnicity; broadly explains the collection of individuals united by ties of culture and or hereditary, who are conscious of forming a sub group within the society.


33 UNDP,(2005), Central Asia Human Development Report, op.cit., p. 53


35 UNDP, Central Asia Human Development Report op.cit, p. 55


Ibid., p. 242.

Ibid., p. 246.


(Asian Development Outlook, 2005, P, 21)
Map 2: Political Map of Central Asia