Book

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CAREC INTEGRATED TRADE AGENDA 2030

ISSUES PAPERS

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6 ADB Avenue, Mandaluyong City, 1550 Metro Manila, Philippines
Tel +63 2 632 4444; Fax +63 2 636 2444
www.adb.org

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Contents

CITA Issues Paper No. 1
Addressing Technical Barriers to Trade

1. Nontariff barriers (NTBs) are now probably more important than tariffs in restricting market access for exports.[1] This lends added importance to identified priority for Central Asia Regional Economic Cooperation (CAREC) members to accede to the World Trade Organization (WTO) and implement its rules and disciplines. The WTO has a number of agreements that seek to ensure that trade-related regulations used by governments avoid becoming unnecessary barriers to trade and are transparent, predictable, and nondiscriminatory, applying equally to domestic products and imports of like products, from all sources.[2] Respect for the disciplines of these agreements is an "essential means of ensuring that countries can attain their public policy goals while benefiting from open trade." [3]

2. Important among such WTO agreements are those on technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures. The two agreements are distinct. The scope of the TBT agreement is wider than that for SPS, with the latter dealing with specific risks related to human health, mainly on food safety, and animal and plant health, including protection from pesticides. Meanwhile, the TBT agreement excludes SPS measures from its scope and deals with measures pertaining to national security, deceptive practices, and protection of the environment.

3. In certain cases, the distinction between the two agreements is somewhat unclear. For example, a single measure on food products could contain a requirement on the spread of pests (which is relevant to SPS) and on labeling and grading (which is relevant to TBT). Thus, the issues arising in the implementation of agreements, such as conformity assessment, are essentially similar.

4. The CAREC Integrated Trade Agenda 2030, with a view to lowering trade costs (pillar 1), includes support for the implementation by its members of the TBT and SPS agreements. However, CAREC work on TBT is in its nascent stage, unlike that for SPS. In 2015, CAREC ministers endorsed the Common Agenda for Modernization of Sanitary and Phytosanitary Measures for Trade, including a modernization of SPS systems and infrastructure. The Rolling Strategic Action Plan (RSAP) 2018–2020 already identifies focused SPS-related projects, including needs assessments in various CAREC countries. Given the inherent risk of TBT measures becoming NTBs, and hence an impediment to regional integration, CAREC might do well to accord a similar priority to TBT.

[1] World Trade Organization (WTO). 2012. *World Trade Report 2012 – Trade and public policies: a closer look at nontariff measures in the 21st century*. Geneva; and United Nations Conference on Trade and Development. 2013. *Non-Tariff Measures to Trade: Economic and Policy issues for Developing Countries*. Geneva.

[2] Nontariff measures need not restrict imports, per se: indeed, for example, abidance by safety regulations may increase demand for the product as public confidence grows, but unnecessarily burdensome conformity assessment procedures for such abidance may well restrict trade, becoming a nontariff barrier.

[3] WTO. The WTO Agreements Series. Technical Barriers to Trade. www.wto.org.

5. It is of note for CAREC that a growing number of regional agreements contain provisions on TBT and/or SPS measures; in fact, some 60% of regional trade agreements contain such provisions, with harmonization and mutual recognition thought to be steps toward more open trade (footnote 1).

6. Harmonization implies a common regulation between (or among) countries, which may include conformity with an international standard,[4] as both the TBT and SPS agreements encourage, while mutual recognition is the reciprocal acceptance of each other's measures. Although the evidence is not totally clear, both approaches are considered trade enhancing between partners as they increase the possibility for economies of scale and foster a more efficient allocation of resources.[5] In general, harmonization is expected to boost trade more than mutual recognition in that in the former case products are likely to be more homogenous, reducing the home country bias.[6] Mutual recognition tends to favor a wider variety of the products, thus enhancing consumer choice.

7. However, (i) harmonization could give rise to differing compliance costs among partners, meaning that the benefits may not be equally shared, whereas mutual recognition avoids the costs of adaptation to a "new" harmonized regulation; and (ii) in settling on a harmonized standard, bargaining power is likely to be important, which could disadvantage smaller members and incidentally reinforces the encouragement in the TBT and SPS agreements to seek conformity with international standards.[7] In this respect, harmonization following international standards may improve access to markets within the CAREC region and beyond.

8. The harmonization and mutual recognition approaches are likely to have different effects on third countries. Harmonization tends to reduce the "learning" costs for entry by third parties, enlarging the possibilities for CAREC countries for the sourcing of imports, although it may impose compliance costs. Mutual recognition encourages third parties to seek exports to the country with regulations that best suit its production technology, perhaps narrowing supply possibilities for some CAREC members.

9. The choice of harmonization or mutual recognition varies across regional arrangements. Agreements by North American countries tend to favor mutual recognition of technical regulations, while agreements of the European Union frequently contain harmonization provisions.[8] However, mutual recognition of conformity assessment is a feature that occurs across many types of regional arrangements such as in Association of Southeast Asian Nations.

10. Conformity assessment is the process for determining whether a product is in compliance with a regulatory measure. In the case of TBT (and SPS) measures, conformity assessment, including testing, inspection, and certification, can entail costs, which are necessary because they ensure compliance with the policy objectives, such as consumer's health and safety. But they could be an

[4] For example, as published by the International Organization for Standardization (ISO).

[5] M.X. Chen and A. Mattoo. 2004. Regionalism in Standards: Good or Bad for Trade? *Policy Research Working Paper*. No. 3458. Washington, DC: World Bank.

[6] However, a "high" standard may also remove lower quality products that some consumers might wish to buy, thus potentially reducing trade.

[7] Some members may lack the expertise to fully take part in such exercises, which is another reason why the CAREC Integrated Trade Agenda and Rolling Strategic Action Plan projects on TBT and SPS are important.

[8] The European Union accords mutual recognition among its members, but also has a wide range of harmonized standards. These are not technical regulations, which are obligatory, but rather are voluntary and developed by a recognized European Standards Organization, such as the European Committee for Electrotechnical Standardization (CENELEC); these standards support the legal requirements, but manufacturers and conformity assessment bodies are free to choose other technical solutions to ensure that the requirements are met.

impediment to trade. For example, if the exporting country has the necessary facilities and capability to test the product for compliance with regulations in a cost-effective way, it could be duplicative to undergo conformity assessment again in the importing country. In fact, these assessments are widely viewed as NTBs. A business survey by the International Trade Centre reported that more than 50% of all complaints about TBT/SPS measures in 11 countries analyzed dealt with conformity assessment (footnote 1). As such, it would seem that the proposal for the mutual recognition of laboratory results and acceptance of SPS certification could be a way forward. A similar CAREC project for TBT would be of real value.[9]

11. In conclusion, TBTs measures are part of the trading environment. They help to achieve public policy goals, including human health and safety. However, they are not meant as a shield for domestic producers against foreign competition, thus potentially limiting a country's potential benefits. Nevertheless, they will have trade effects. Compliance with the WTO's agreements, as well as potential regional or bilateral harmonization and mutual recognition, could help attenuate any negative trade effects of these measures. This underscores the importance of continued capacity building in CAREC to plan and implement appropriate TBT regulatory environments.

[9] This process might be relatively straight forward for some CAREC countries to the extent that they maintain the Gosudarstvennye Standarty State Standard (GOST standards), especially if these have been revised to conform to international standards. Some CAREC countries have adopted GOST standards in addition to their own nationally developed standards.

CITA Issues Paper No. 2
Expanding Trade in Services

1. Services contribute significantly to gross domestic product (GDP) and job creation, representing roughly 70% of global production.[1] For Central Asia Regional Economic Cooperation (CAREC) countries, the services value added as a proportion of GDP ranges from 36% to 58%, while trade in services to GDP ratio varies more widely, between 5% and 40% in 2017. For most of CAREC countries, the share of the total workforce employed in services sectors exceeds 40%.[2]

2. Services frequently join up or lubricate markets that would otherwise stand separately in a disjointed manner, compromising growth and economic opportunities. More specifically, what are often referred to as "producer services" are essential to the functioning of practically every sector in any economy. These include financial services (such as banking, insurance, and brokerage services), business services, transport, communication, energy, and distribution.

3. This widespread dependence on producer services means that, as economies grow, services sectors grow even more. A similar story prevails on the consumption side of the economy. As people become richer, their consumption preferences are tilted increasingly toward services, such as travel, entertainment, and leisure activities, all of which are services-intensive.

4. The new long-term strategic framework for the CAREC region (CAREC 2030) as well as national strategies illustrate the centrality of the services economy. The operational clusters and associated policy areas identified under CAREC 2030 cover a major part of the regional economy, and in no small measure comprise services activities. These are the realities that make services key to development, diversification, and economic growth.

5. Despite their prominence, services have been relatively neglected in economic analysis and policy. This comparative inattention to services as a source of value in production, trade, and consumption is the result of several factors. Two of the most important ones for the present purposes are, first, in contrast to goods, services are intangible and more difficult to measure. Second, services are frequently embedded as inputs in goods and other services, so they are not separately identified in aggregated statistics. Considerable work has been undertaken since the last decade to remedy the "services gap," but much remains to be done both on the policy and statistical sides.

6. Trade is clearly a prominent component of CAREC's future prosperity. Relatively recent breakthroughs enabled by greater data availability and enhanced data processing capacity have permitted us to gain important insights into the significance of services in trade. In the past, governments were only able to report gross trade flows in their national accounts. This meant that

[1] UNCTADstat. http://unctadstat.unctad.org/EN/ (accessed 22 October 2018).

[2] Services value added to GDP data excludes Afghanistan, Tajikistan, and Turkmenistan. Trade in services to GDP ratio data excludes Turkmenistan and Uzbekistan. World Bank. World Development Indicators. (https://data.worldbank.org/indicator) (accessed 22 October 2018).

the measure of a country's exports did not distinguish between the domestic sources of value and the imported value embodied in the data. Domestic value added and foreign value were simply added together, and there was no way of knowing what share of export value was produced in the domestic economy rather than being imported.

7. Even worse, on this basis, it was not only impossible to know the geographical source of value, but also its product composition. Once this hurdle was crossed through the use of value added as opposed to gross data, it transpired that the value of services in trade was far higher than previously reported. Services have been recently estimated to account for 40% world trade in value-added terms, and the services content of exports is about 46% for developed countries and 33% for developing countries.[3]

8. Unfortunately, trade numbers measured in value-added are not easy to compile for all countries. They require a sophisticated dataset that can trace the sources of value in an economy through an input–output table.[4] This has led to many misperceptions about what a country actually exports. Perhaps the best-known illustration of the problem is the 2010 Asian Development Bank Institute study on the value chain of an iPhone, which has provoked a significant literature on the subject.[5] The basic point is that, as the People's Republic of China (PRC) was the last stop in the production chain for iPhones, United States imports would record the product as an export of the PRC. This was a gross misrepresentation because the PRC's contribution at the time of this study comprised a modest share of total value added generated at the assembly stage. All the services and other components entering the production process were produced elsewhere, including in the United States. This kind of accounting not only inflated the PRC's real trade surplus with the United States, but also mis-specified the technological content of the bilateral trade flow and failed to reveal the true sources of trade and trade interdependency implied by these patterns of exchange. The value-added data also served to demonstrate that export success is not possible without imports—an important policy message for diversification policies that fail to recognize that not all imports can be replaced by domestic production.

9. This deviation into the technicalities of measuring trade flows is not without purpose when considering the appropriate stance of governments in relation to services activities in their economies. One important message is that services are often "hidden" inputs into production processes. Neglect of their role and relevance is a recipe both for bad business decisions and bad policy. The old saying that a chain is only as strong as its weakest link applies to this world, where many product markets (goods and services) intertwine in production and trade.

10. Other valuable insights relate to the issues of tradability and productivity. Traditionally, services were regarded as largely untradeable, low productivity segments of the economy, necessary but unpromising in terms of growth, trade, and development. However, when actual

[3] R. Lanz and A. Maurer. 2015. Services and global value chains: Some evidence on servicification of manufacturing and services networks. *WTO Staff Working Paper No. ERSD-2015-03*. March 2015.

[4] A recent Asian Development Bank (ADB) study of global value chains reveals that, on the one hand, backward participation ratios (the foreign value-added contribution to a country's exports) for a country could be low because inputs are sourced domestically, e.g., Pakistan's textiles, or Kazakhstan's minerals, which are primary goods that require few intermediate inputs. On the other hand, forward participation ratios (a country's value-added contribution to the production of foreign economies) are high for Kazakhstan and Mongolia because their exports are natural resource-based and at the upstream segment of value chains. ADB. 2018. *Key Indicators for Asia and the Pacific 2018*. Manila (p. 206).

[5] Y. Xing and N. Detert. 2010. How the iPhone Widens the United States Trade Deficit with the People's Republic of China. *ADBI Working Paper 257*. Tokyo. https://www.adb.org/sites/default/files/publication/156112/adbi-wp257.pdf.

sources of value are properly identified, the picture changes significantly. For a start, it is definitely the case that all services entering the production process are potentially tradable, depending on what other sources of value they are bundled with in the production process.

11. For example, the cleaners of a factory and the repairers of factory machinery in an establishment producing footwear for export are also exporters, since their contributions enter the value of the final product. Similarly, product designers and other high-technology suppliers of value that is putatively supplied locally is also exported. The only services that are technically untradeable are certain consumption services such as restaurant and hotel services, although the international definition of services includes foreign suppliers of facilities supplying such services, and these count as traded product as well.

12. As for the productivity story, services—especially government-supplied services such as health and education—were traditionally considered technologically static and incapable of significant improvements in terms of productivity and efficiency levels. How productivity gains emanate both from product and process innovations, and how the bundling of inputs matters in fostering efficiency have illuminated the contribution of services to productivity growth. The growth of the knowledge economy and the increasing importance of intangible capital in economic activity have also clarified where services fit in.

13. As far as international cooperation is concerned, trade in goods has been subject to a multilateral regime for 70 years. But it was not until the 1980s that governments started to think about international rules for trade in services, and not until the mid-1990s before the General Agreement on Trade in Services (GATS) entered into force under the auspices of the World Trade Organization.

14. Much is made of the differences between goods and services, although the only immutable distinction between them is that goods are tangible, and services are not. Nevertheless, the manner in which services are traded is often different from that of goods. Services more frequently require simultaneous production and consumption along with physical proximity for transactions to occur, such as in the case of hairdressing services. Services are often more heterogeneous than goods subject to mass uniform production. For example, no two visits to the dentist will result in the delivery of an identical product.

15. The proximity constraint for services delivery has resulted in a GATS definition of services that distinguishes among four modes of supply. Mode 1 is cross-border delivery, akin to trade in goods. Mode 2 involves consumption abroad, either where the consumer has crossed a frontier to consummate the transaction or the supplier is a foreign entity. Mode 3 offers domestic commercial presence (i.e. investment rights) to foreign services firms. Finally, Mode 4 allows individual suppliers of services, either in an independent capacity or as employees of services firms to work in a foreign market. As far as Mode 4 is concerned, it is important to note that the movement of people is designed only to facilitate the non-permanent or mere temporary presence of services providers. It has nothing to do with immigration and the movement of populations.

16. All of these rights to market access are negotiated and inscribed in schedules of specific commitments. It is for governments to decide how far they want to open up and gain the advantages of trade and specialization, measured against their broader economic strategies. For instance, services trade regulations in some CAREC countries appear to be relatively restrictive in insurance and air passenger transport and auditing under Mode 1; in professional services,

banking, insurance, communication under Mode 3; and professional services under Mode 4.[6] Nevertheless, the eight CAREC countries that are World Trade Organization members made commitments on 20%–85% of 56 services subsectors. The subsectors that all eight committed to were telecommunication, banking, insurance, professional and other business services, and hotels and restaurants; another 23 subsectors had commitments from at least five countries.[7]

17. The prospects for CAREC economies to grow, develop, and prosper depend not only on the policy choices of national governments, but also on their success in regional cooperation. The preponderance of services in so many sectors and activities makes a strong case for paying careful attention to the intangible economy in this regard. The GATS can contribute too through its mechanisms for encouraging cross-border trade, investment, and the movement of people.

[6] The countries included the PRC, Georgia, Kazakhstan, the Kyrgyz Republic, Mongolia, Pakistan, and Uzbekistan. World Bank Services Trade Restrictions database (iresearch.world.org/servicetrade) (accessed 19 September 2018).

[7] WTO and World Bank. Integrated Trade Intelligence Portal (i-tip.wto.org/services) (accessed 20 September 2018).

CITA Issues Paper No. 3

Engaging in Regional Trade Agreements

1. Regional trade agreements (RTAs) can promote the economic integration of its members, to the possible benefit of their growth, with improved price and quality choices for their consumers.[1] They have proliferated since the early 1990s and now number well over 300 globally. In the case of goods, an RTA may be either a customs union, with a common tariff for imports from non-members, or a free trade agreement (FTA), with each partner retaining sovereignty over its tariffs for nonmembers, but then requiring rules of origin for the movement of goods among themselves. Each of these may be complemented by arrangements for trade in services among its members, as is the case for about one half of all RTAs. In addition, an RTA may include provisions to deepen the links between participating countries on trade-related matters, including standards, sanitary and phytosanitary (SPS) measures, customs procedures, rules of origin, e-commerce, and intellectual property rights. At present, each member of the World Trade Organization (WTO) is party to at least an RTA.

2. CAREC's long-term strategy has stated that in "going forward, CAREC will assess the shifting landscape of global and regional trade paradigms and the potential of moving toward free trade agreements (FTAs) in the region."[2] Each CAREC member country already has at least one FTA, although not in each instance with another CAREC partner: Mongolia's only RTA is with a non-CAREC country (Japan), but each of the others are in RTAs with at least one other CAREC member. Intra-CAREC, Georgia has been the most active, having notified four FTAs to WTO, including one on goods and services with the People's Republic of China (PRC), which entered into force in January 2018. The PRC and Pakistan joined in a goods FTA in 2008, which was subsequently extended in 2010 to include services. Kazakhstan, the Kyrgyz Republic, Pakistan, and Turkmenistan are also partners in bilateral intra-CAREC FTAs, although that between Kazakhstan and the Kyrgyz Republic is now superseded by the membership of both in the Eurasian Economic Union (EAEU), which is a customs union and single market. Afghanistan, together with Pakistan, is a member of the South Asian Free Trade Area, but is not party to a solely intra-CAREC agreement.

3. The European Union (EU) is an outstanding example of an RTA serving the end of economic integration among its members. The EU, with a customs union at its core, is a single market for its members with free movement for goods, services, capital, and labor. It should be noted that (i) the EU has supplemented its own internal arrangements with wide-ranging market opening and integration to third parties through (carefully calibrated) bilateral and multilateral agreements (i.e., the WTO) with nonmembers; and (ii) no member of the EU has a trade arrangement in its own right with a third party—the EU negotiates as a block. Among FTAs, the former North American Free Trade Agreement and the Australia-New Zealand Closer Economic Relations Trade Agreement are examples of successful integration. Both agreements

1 "Regional trade agreements" is the term used by the World Trade Organization (WTO) for agreements that come in many shapes and forms but generically are either free trade agreements (FTAs) or customs unions.

2 Asian Development Bank. 2017. *CAREC 2030: Connecting the Region for Shared and Sustainable Development*. Manila.

are very deep, with comprehensive coverage of not only goods and services but seeking to deal also with nontariff barriers and investment, and parties to the agreement have sought market opening beyond their own agreements through other FTAs and by active participation in the WTO. The lessons are reasonably clear that RTAs should be deep and be complemented by other arrangements to promote greater integration and maximize the potentials in these agreements.

4. To date, the Georgia–PRC FTA appears to be a good example of an FTA with deep coverage. It provides that Georgia will impose zero tariffs on 96.5% of the PRC's products immediately, covering 99.6% of the total imports from the PRC, and the PRC will impose zero tariff on 93.9% of Georgia's products, covering 93.8% of the PRC's total imports from Georgia, of which 90.9% (taking up 42.7% of imports) will have zero tariffs immediately and the remaining 3% (taking up 51.1% of imports) will gradually have zero tariff within 5 years. In terms of trade in services, both sides will open further their markets to each other on the basis of their WTO commitments. In addition, both sides have reached broad consensus in many fields such as environment and trade, competition, intellectual property, investment, and e-commerce. In addition, both have FTAs in force with other partners, e.g., the PRC with 15 and Georgia with 11, and both are active in the WTO.

5. But some select words of warning are in order. RTAs provide their members with preferential access to their markets. In so doing, they run counter to the WTO's cornerstone principle of nondiscrimination. This preferential access will almost invariably lead to trade diversion, with imports no longer being sourced from what would otherwise be the low-cost supplier, to the detriment of the multilateral trading system. Yet, the WTO permits RTAs on condition, inter alia, that they cover "substantially all the trade," in the case of goods, and "substantially all sectors," in the case of services, between the parties, with then the possibility that the RTA will result in net trade creation, to the potential benefit of the system. This argues for broad coverage.

6. In the case of FTAs, rules of origin are also a possible area of concern. They can be costly to meet, perhaps undercutting economies of scale, especially if a country has a web of FTAs—the phenomenon called spaghetti bowl effect.[3] This can be met by calibrating the rules across various FTAs, with the EU's Pan-European Rules of Origin serving perhaps as an example, but it requires willing partners or adoption of options, including flexible cumulation rules.

7. Policy makers will also need to be careful not to becloud the trading environment for their economic actors, which behooves them to maintain full, readily accessible transparency on all agreements, to allow appropriate market selection. In addition, the authorities should remain fully engaged in, and in conformity with, the WTO, despite its present difficulties, as the single venue where all their trade concerns potentially can be addressed on multilateral level.

8. Given the above, possibilities are available for improved CAREC integration following the FTA route. Non-EAEU CAREC members could seek bilateral FTAs with each other, including in services. Were such a path to be followed it would be very useful if parties could agree on and follow a single template that obviates differing rules of origin and, thus, reduces complexity and trade costs. It would also serve integration if members could agree to cumulation across their FTAs with fellow CAREC members and if they pursued mutual recognition and/or harmonization

[3] The term refers to the complications that arise when, for example, producers face differing rules of origin for the same product to the various markets with which a country may have an FTA.

of standards; for example, in SPS. In addition, parties should be careful to meet WTO provisions on RTAs, ensuring significant coverage in both goods and services, if possible, and perhaps to go beyond the WTO by including areas such as investment and competition. Non-EAEU CAREC members could also seek to form a single FTA among each other, but this may be both more difficult and time-consuming than the bilateral route.

9. If and when a formal proposal to consider an RTA among CAREC member countries is tabled, each CAREC member will decide on a voluntary basis and, in view of their own circumstances, whether to join such an agreement. Participation by any CAREC member will not be mandatory under any circumstance.

CITA Issues Paper No. 4
Establishing Special Economic Zones

1. The matter of special economic zones (SEZs) is both one of significant interest and of some concern. On the one hand, an SEZ can help to transform a small fishing village (Shenzhen, People's Republic of China) into the vanguard of a nation's economic development. On the other hand, inter alia, they can create distortions in an economy, which is a reason why it is thought that it is normally preferable to liberalize on a nationwide scale rather than on a patchwork basis.[1] The Central Asia Regional Economic Cooperation (CAREC) Integrated Trade Agenda 2030 and its accompanying Rolling Strategic Action Plan 2018–2020 proposes feasibility studies on the establishment of free trade zones and/or cross-border economic zones in a number of CAREC member countries. The importance of identifying the pros and cons of such zones, and of learning from the experience of other countries, cannot be overemphasized.[2]

2. SEZs may be defined as "clearly defined geographically, with a single management or administration and separate customs area (often duty free), where streamlined business procedures are applied and where physically located firms qualify for more liberal and effective rules than those in the national territory covering, for example, investment conditions, international trade, labor conditions, customs, and taxation."[3] Aside from incentives, services and infrastructure are also provided to SEZs resident companies.[4] Thus, economic actors in the SEZ can produce and trade at lower, more globally competitive prices, which could potentially contribute for increased productivity and economic development of each country. Despite certain misgivings, SEZs are viewed as a viable tool of industrial policy, which dovetails into economic corridor development. Many CAREC countries have introduced and established varying types of SEZs.

3. While the World Trade Organization (WTO) accession, which is a CAREC priority for its members, does not have explicit provisions for SEZs, it is understood that a member's WTO commitments will apply uniformly throughout its customs territory, including to any and all its SEZs. Indeed, since 2000, most recently acceding members have agreed to this specifically, including the PRC, Georgia, Kazakhstan, and Tajikistan, among CAREC members.[5] In 1998, the Kyrgyz Republic also took this commitment upon its accession and, in addition, agreed to bring its existing SEZ measures into full conformity with the WTO.[6] Mongolia undertook similar commitments in 1997.[7]

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1 *The Economist*. Special Economic Zones: Not So Special, 4 April 2015.

2 Asian Development Bank (ADB). 2018. *A Diagnostic Study of Kazakhstan's Special Economic Zones and Industrial Zones*. Manila; and ADB. 2018. *A Diagnostic Study of Kyrgyz Republic's Free Economic Zones and Industrial Parks*. Manila.

3 ADB 2015. *Asian Economic Integration Report 2015: Special Chapter - How Can Special Economic Zones Catalyze Economic Development*. Manila.

4 Typically, an SEZ is within the boundaries of one county but it could be an across-the-border arrangement.

5 WTO Working Party Reports CHN73 (11/12/2001), GEO40 (14/06/2000), KAZ208 (30/11/2015), and TJK (2/03/2013).

6 WTO Working Party Reports KGZ83 (20/12/1998) and KGZ115 (20/12/1998).

7 WTO. 1997. WTO Protocol of Accession MNG-PO3 (29/01/1997).

4. Ideally, SEZs foster economic development both inside and outside the zones. Inside a zone, the aim is to attract investment, particularly foreign direct investment, with its attendant technology, to bring new firms, especially those in global value chains, jobs, and "know-how". Outside the SEZ, states aim to have the zones generate synergies, networks, and spillovers, especially of knowledge, that will engender additional economic activity and national growth. A number of factors are thought to be of some significance in achieving these effects.[8] Among these is the size of the zone that should be sufficient to house multiple companies, to improve the possibilities for both horizontal and vertical agglomerations with the subsequent increased chance of positive externalities; for example, with respect to transport and knowledge sharing.

5. Another factor of some importance would seem to be the location of the zone. It would appear best for an SEZ to be close to a fairly large center, particularly one with good transport links to foreign markets. This could enhance, inter alia, the availability of an appropriate labor pool and the feasibility of spillovers, especially if those outside the zone are able to fit into zonal, and perhaps, global value chains.

6. Also of considerable import is the administration of the zone. It needs to be the center of good governance, a one-stop shop for all the necessary licenses, for coordinating activities in the zone, and ensuring that the resident companies efficiently receive the promised incentives and services. Failing this, the appropriate functioning of the zone could well be jeopardized.

7. There are possible downsides to SEZs. Among them is the fact that they offer, as noted, preferences not available to the rest of the national economy. By their nature, preferences divert resources, creating distortions, potentially leading to economic inefficiencies. In this context, it is not inappropriate to note that the literature is replete with examples of preference-policies leading to balance-of-payments difficulties. In this respect, it might be as well, as with most industrial policies, to make the preferences time-bound, encouraging the resident companies to integrate into the rest of the economy once they have become internationally competitive.

8. As a corollary to the above, SEZs may lead to unequal geographic development, especially if there are limited spillover effects; certain regions and classes will benefit but without significant positive effects on national socioeconomic development, leading to possible discontent.

9. SEZs can be costly. The revenue foregone in consequence of the possible tax and tariff incentives, as well as the cost of setting them up, may constrain a government's fiscal resources for the needs of the rest of the economy. While this may a short-term phenomenon if the SEZ succeeds, in the interim the "outside" economy may be deprived of the resources (e.g., infrastructure, education) to allow it to catch up at a later stage; it could become caught in a lower middle-income trap. Again, spillovers are essential, as is perhaps a time-bound policy for SEZs.

10. In these respects, as a concentration of competitive firms, SEZs could be used as the centerpiece of a cluster-development strategy. Policies to leverage SEZs to promote clusters and enhance productivity are thus required, including on (i) improving the attractiveness of SEZs for investment into global value chains; (ii) promoting spillovers, (iii) forming regional and

[8] World Bank 2017. *Special Economic Zones: An Operational View of Their Impacts*. Washington, DC; and ADB. 2016. *The Role of Special Economic Zone in Improving Effectiveness of GMS Economic Corridors*. Manila.

cross-border value chains, and (iv) establishing a sound implementation strategy and monitoring and evaluation frameworks.[9]

11. In short, it is not a simple matter to decide on the establishment and nature of an SEZ. It seems clear that a zone will function best in a sound, stable macroeconomic environment, with attendant good governance and policies that encourage spillovers and, possibly, with time-bound incentives. In any event, it would be untoward to embark on an SEZ without a prior feasibility study, including a determination as to whether an SEZ would be preferable to nationwide liberalization.

[9] ADB. 2018. *Strategic Framework for Special Economic Zones and Industrial Zones in Kazakhstan*. Manila.

CAREC Integrated Trade Agenda 2030 Issues Papers

The publication tackles some of the key issues and priority areas under the Central Asia Regional Economic Cooperation Program (CAREC) Integrated Trade Agenda 2030 to support policy deliberations and implementation at the regional and national levels. These include (i) addressing technical barriers to trade, (ii) expanding trade in services, (iii) engaging in regional trade agreements, and (iv) establishing special economic zones.

About the Central Asia Regional Economic Cooperation Program

The Central Asia Regional Economic Cooperation (CAREC) Program is a partnership of 11 member countries and development partners working together to promote development through cooperation, leading to accelerated economic growth and poverty reduction. It is guided by the overarching vision of "Good Neighbors, Good Partners, and Good Prospects". CAREC countries include: Afghanistan, Azerbaijan, the People's Republic of China, Georgia, Kazakhstan, the Kyrgyz Republic, Mongolia, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan.

About the Asian Development Bank

ADB is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. Established in 1966, it is owned by 67 members—48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

ADB CAREC

CAREC SECRETARIAT
www.carecprogram.org
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
E-mail: info@carecprogram.org
Website: www.carecprogram.org