Trade and Investment Relations among the Member States of the Turkic Council:

Current State and Prospects for Regional Integration

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Prepared by SESRIC Staff

Kenan Bagci, Cem Tintin and Erhan Türbedar

Contents

Acronyms

ADB	Asian Development Bank
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
DAC	Development Assistance Committee
DB	Doing Business
DOTS	Direction of Trade Statistics
EAEU	Eurasian Economic Union
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECO	Economic Cooperation Organization
EEC	Eurasian Economic Commission
EPI	Export Potential Indicator
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GNI	Gross National Income
GSP	Generalized System of Preferences
GVC	Global Value Chain
HS	Harmonized System
ICT	Information and Communication Technology
ILO	International Labour Organisation
IMF	International Monetary Fund
IPR	Intellectual Property Rights
ITC	International Trade Centre
KILM	Key Indicators of Labour Market
LDCs	Least Developed Countries
LPI	Logistic Performance Index
MFN	Most Favoured Nation

NTM	Non-Tariff Measures
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OIC	Organisation of Islamic Cooperation
PPP	Purchasing Power Parity
R&D	Research and Development
RCA	Revealed Comparative Advantage
RTA	Regional Trade Agreement
SDG	Sustainable Development Goal
SEZ	Special Economic Zone
SME	Small and Medium-sized Enterprise
SPS	Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TC	Turkic Council
TCI	Trade Complementarity Index
TII	Trade Intensity Index
TFI	Trade Facilitation Indicators
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNIDO	United Nations Industrial Development Organization
UNSD	United Nations Statistics Division
USA	United States of America
USD	United States Dollar
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WEO	World Economic Outlook
WTO	World Trade Organization

Foreword by SESRIC

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Foreword by Turkic Council

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Executive Summary

1. This study investigates the current trade and investment patterns in Turkic Council Member Countries (TC MCs), analyse the bottlenecks in promoting trade and investment, and propose alternative policy measures on how to enhance trade and investment among the member countries. The study covers four TC MCs, namely Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey, which are also the members of the Organization of Islamic Cooperation.

2. The combined **GDP** of the Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey was worth $990.1 billion in 2018, and represented 2.2% of the world economy. Turkey dominates within the combined GDP of the TC MCs, accounting for above 75% of it in 2018. Real GDP growth figures for last three years continue to display stable growth momentum for the TC MCs, with the exception of Turkey.

3. In 2018, Turkey recorded the highest level of **GDP per capita** among the TC MCs, at $9,346. With a very close figure to Turkey, $9,237 GDP per capita puts Kazakhstan at the second place, followed by Azerbaijan in the third place ($4,569). GDP per capita is significantly lower in Kyrgyzstan at $1,268, where near 26% of population is living below the national poverty lines, according to the World Bank data.

4. A key weakness of the TC MCs is low or very low share of **manufacturing**. From 1990 to 2017 share of manufacturing in GDP has significantly fallen in Azerbaijan, Kyrgyzstan and Turkey. **Agriculture**'s share in economies of the TC MCs has progressively declined to less than 7% in Azerbaijan, Kazakhstan and Turkey. However, the agriculture's importance in economic and social fabric of the TC MCs goes well beyond this indicator, due to food security dimension as well as many families being dependent on rural incomes.

5. In the TC MCs, economic growth continues to be largely disconnected from **employment** growth. From 2012 to 2018, despite real GDP growth, unemployment in Azerbaijan and Kazakhstan was almost stabilized at around 5%. In the same period, with contribution of expatriate working population the labour situation has improved in Kyrgyzstan, where total unemployment is reduced from 8.4% to 6.8%, while unemployment in Turkey rose from 8.2% in 2012 to 11% in 2018.

6. In 2017, 96% of **export basket** of Azerbaijan and 86% of exports basket of Kazakhstan were primary products and resource-based products. In the same year, share of

medium-tech products in the export basket of Turkey was 35%, while the same data for Kazakhstan, Kyrgyzstan and Azerbaijan remained at 11%, 8% and 2% respectively.

7. Compared to 2015, the **volume of external finance** available to the TC MCs has substantially increased to $108.3 billion in 2017. Near 80% of this amount ($87 billion) went to Turkey, 10% to Kazakhstan ($11.1 billion), 7% to Azerbaijan ($7.1 billion) and 3% or $3.2 billion to Kyrgyzstan.

8. **Remittance inflows** to the TC MCs have reached a $5 billion in 2017. This is an 18% increase from 2016, when the amount was $4.1 billion. It should be noted that remittance inflows were largest source of external finance for Kyrgyzstan in 2017, reaching a record high of near $2.5 billion, or 32% of its GDP – among the highest in the world.

International Trade among the TC MCs

9. Total **exports** among the TC MCs reached its highest level in 2012 by exceeding USD 9.3 billion. Over the following four years, it constantly fell to reach USD 5 billion in 2016. Since then, an upward trend has been observed in total intra-TC exports, which is recorded almost USD 6.8 billion in 2018. After declining from 2.7% in 2012 to 2.2% in 2015, the share of intra-TC trade remained fairly stable over the last four years and recorded at 2.3% in 2018.

10. It is observed that Turkey and Kazakhstan were accounting around 90% of all **intra-TC trade** until 2016, while Azerbaijan and Kyrgyz Republic were each accounting around 4-6% over the same period. However, Azerbaijan expanded its trade relations with all other TC MCs since 2016 and started to account greater share of intra-TC trade. As of 2018, Azerbaijan accounts for 27.7% of total intra-TC trade, while the shares of Turkey and Kazakhstan declined to 37.6% and 29.9%, respectively.

11. Kyrgyz Republic still has the highest **share of trade** with other TC MCs in 2018 with 16.7% share. It is followed by Azerbaijan (11.7%) and Kazakhstan (3.2%). Although Turkey has the largest share in intra-TC trade, its share in total trade of the country is only 1.1%. On average, intra-TC trade plays increasingly greater importance in Azerbaijan's and Kyrgyzstan's trade over time, but lesser importance in Turkey's and Kazakhstan's trade.

12. **Bilateral trade relations** of individual TC MCs show high concentration of trade flows. Figure 2.6 shows the share of trade partners of each TC MCs for the years 2010 and 2018. Turkey has been the main trade partner within the TC region for Azerbaijan. Kyrgyz Republic became a more important partner for Kazakhstan, diminishing the importance of Azerbaijan over the years. For Kyrgyz Republic, importance of Turkey in its trade relations substantially increased, resulting in a fall in the share of Kazakhstan. For Turkey, Kazakhstan remained its major trade partner, but its share declined seven percentage points, while the share of Kyrgyz Republic increased six percentage points.

13. At **sectoral level**, manufactured goods had the highest share during 2000's and, with a share of 29.2%, it became an even more important sector in bilateral trade relations

among the TC MCs. The second most important sector is mineral fuels, lubricants and related materials. Particularly Azerbaijan and Kazakhstan are rich in natural resources and these resources constitute a significant share of their exports. During 2010's, mineral fuels accounted for 23.4% of total intra-TC trade. The third important sector is machinery and transport equipment, whose share is however declined from 17.2% to 13.1%.

14. In terms of **trade policies**, Azerbaijan applies the highest Most Favoured Nation (MFN) tariff rates within the TC region with an average rate of 7.4%. In 2019, Kazakhstan's MFN applied tariff averaged 4.3% and preferential rate was recorded at 3.9%. Average tariff applied by Kyrgyzstan were also relatively low. Average MFN applied tariff was 5.0%, while preferential rate was 4.5% in 2019. Turkey's applied MFN and preferential tariff rates average 6.6% and 5.4%, respectively. However, Turkey continues to maintain high tariff rates on many imported food and agricultural products. In 2018, Turkey applied 57.8% MFN tariff rates and 56.4% preferential tariff rates.

15. As part of Eurasian Customs Union, Kazakhstan and Kyrgyzstan enjoys zero tariff rates in their trade with each other. Azerbaijan, Kazakhstan and Kyrgyzstan have preferential tariffs within the framework of CIS agreements. Turkey applies non-MFN tariffs to Azerbaijan, MFN tariffs to Kazakhstan and preferential tariffs to Kyrgyzstan within the framework of Generalized System of Preferences (GSP). It is evident that although trade restrictions among Azerbaijan, Kazakhstan and Kyrgyzstan are almost entirely lifted, Turkey's trade relations with these countries linger with certain restrictions.

16. An important indicator of trade facilitation among the TC MCs is the level of **trade costs**. The largest trade costs are observed between Azerbaijan and Kyrgyz Republic and it is almost constantly rising since 2012. In 2016, bilateral trade costs between two countries are estimated at 220% ad valorem, which indicates that an additional cost of 2.2 times of original value of goods are incurred in their shipment from producers to local customers. Trade costs between Azerbaijan and Kazakhstan has more than doubled between 2008 and 2015 by increasing from 79% to 165%. Azerbaijan's trade costs with Turkey is comparably low. It generally fluctuates between 80%-100% and as of 2016 it stands at 95%. The lowest trade costs are observed between Kazakhstan and Kyrgyz Republic where geographic proximity plays a great role.

17. Due to higher protectionism and perishable nature of products in agricultural sector, trade costs for agricultural products are higher than manufactured goods. Overall, it is promising to observe a fall in trade costs in agricultural products, but it is also quite worrisome to see rising costs of trade in manufacturing goods.

18. Concerning **trade facilitation**, Turkey has the highest score with 1.48, indicating that it made the most progress in facilitating trade, according to OECD Trade Facilitation Indicators. With an average score of 1.12, Azerbaijan shows a moderate performance in trade facilitation. Kyrgyzstan and Kazakhstan need to focus more attention to specific aspects of trade facilitation to improve their overall trade facilitation performance.

19. There are also significant gaps between what individual TC MCs could export and what they actually export. Azerbaijan has the largest **untapped export potential** with Turkey. They could export more than USD 100 million worth of products to Turkey in addition to what it currently exports. Its untapped potential with Kazakhstan and Kyrgyzstan is relatively lower, with USD 31 million and USD 11 million, respectively.

20. Kazakhstan also misses a significant export potential with Turkey. It could export USD 676 million worth of products if factors that prevent the utilization of these potentials. On the other hand, Kazakhstan appears to almost fully utilize its export potentials with Azerbaijan and Kyrgyzstan, where there are only USD 26 million and USD 31 million untapped export potential, respectively. The Kyrgyz Republic have the lowest magnitude of untapped export potential, which is largely due to smaller size of the economy. However, it could export USD 61 million worth of products more than what it actually exports to Kazakhstan, USD 28 million more to Turkey and USD 3 million more to Azerbaijan.

21. Turkey falls short of utilizing a significant amount of export potential with other TC MCs. There is a gap of USD 651 million with Azerbaijan, USD 790 million with Kazakhstan and USD 366 million with Kyrgyzstan between what it exports and what it could export to these countries. In total, Turkey experiences more than USD 1.7 billion untapped export potential. Noting the fact that Turkey export USD 2.5 billion worth of goods to TC MCs, Turkey basically misses around 40% of potential exports to other TC MCs.

Investment Trends and Prospects among TC MCs

22. The total USD value of **FDI inflows** to TC MCs went down from USD 21.6 billion in 2010 to USD 18.2 billion in 2018. In 2018, four TC MCs altogether attracted 1.4% of the total world FDI inflows and hosted 0.99% of the world FDI inward stocks. The share of FDI instocks in TC MCs do not resemble a similar picture. For instance, in Kazakhstan FDI instocks represented a share of 89.4 per cent in the GDP in 2018. In Turkey, it was merely recorded at 17.6%.

23. A similar picture can also be seen with respect to **per capita FDI** directed to TC MCs. As of 2017, Kazakhstan (USD 8,078) and Azerbaijan (USD 3,007) hosted the highest amount of FDI inward stocks in per capita terms among TC MCs.

24. Over the period 2011-2018, in total, 2,119 **greenfield FDI projects** were reported by Turkey and it was followed by Kazakhstan with a number of 512 projects. The number of Special Economic Zones played a great role to attract greenfield projects in these countries. Overall, the figures reveal that independent from how FDI figures are measured, it is difficult to conclude that TC MCs reached their potentials in terms of hosting and attracting foreign investors.

25. On the other hand, a higher volume of **intra-TC FDI** implies the existence of stronger economic ties among them. According to bilateral and regional datasets on TC MCs used in the report, the level of regional economic integration in terms of FDI reveals the

existence of significant untapped potential that needs to be addressed at the Turkic Council cooperation level by establishing proper mechanisms. Finally, the analysis on sectoral concentration of investments in TC MCs provides some hints on how to scale up intra-TC investment.

26. According to the World Bank's ease of doing business indicator, the **business and investment climate** improved in all TC MCs over the period 2016-2019 thanks to national efforts, business-environment related reforms and regional cooperation. For instance, during 2017-2018, Azerbaijan completed reforms in eight areas and it was followed by Turkey that made reforms in seven areas out of ten main areas of the ease of doing business indicator.

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

28. Investors like profit opportunities, and dislike **risks and uncertainties** that could constitute a threat for their investment project or narrow down their manoeuvre area such as by limiting profit transfers or currency exchange. Therefore, they use a series risk evaluations tools to assess the potential countries to invest in. According to the OECD's Risk Classification System, TC MCs obtained scores between 4 and 7 over the period 2005-2019 in a scale of 1 (the lowest risk) to 7 (the highest risk). In this picture, TC MCs should work together to reduce their country risk scores to provide a business environment where there are limited risks and uncertainties for investors.

29. More specifically, according to the Economist Intelligence Unit, **legal and regulatory risk** was placed among top three areas of concern in Azerbaijan, Kazakhstan and Kyrgyzstan among TC MCs. In a similar vein, political stability was identified as an area with a relatively high risk for investors and businesses in Azerbaijan, Turkey and Kazakhstan in 2018. In this regard, TC MCs need to exert more efforts to reduce their risk scores in various dimensions regardless of how the risk is measured.

30. The highest **sectoral concentration of foreign investors** in TC MCs, based on the number of foreign affiliates, was found in the tertiary sector in 2017. It was followed by the secondary and the primary sector. In other words, the country-level data reveal that the tertiary sector is the most attractive one for foreign investors in TC MCs that many of them chose to invest in that sector. Nevertheless, the secondary sector is also found to be strong and competitive particularly in Turkey and Kazakhstan that more than one third of foreign investors went into that sector. It is also revealed that in TC MCs the primary sector hosted a number of foreign investors but in relatively limited numbers

compared to other sectors. In particular, the share of foreign investors in the primary sector exceeded 7% in Kazakhstan that may reflect high potentials for investment.

31. Overall, TC MCs have some similarities in terms of their subsectoral competitiveness for foreign affiliates. On the other hand, there are also some differences among their performance in terms of sectoral concentration and number of hosted foreign affiliates in various sub-sectors.

32. These differences and similarities should be assessed carefully to identify existing investment gaps in specific subsectors. In this way, the investors from TC MCs could complement each other. Nevertheless, this requires development of a Turkic Council investment cooperation framework, which should be paired with a regional investment agreement, with a view to guiding and encouraging investors into the Turkic Council Region.

PART I: Introduction

This Part includes the following chapters:

1 Economic Growth and Foreign Economic Relations

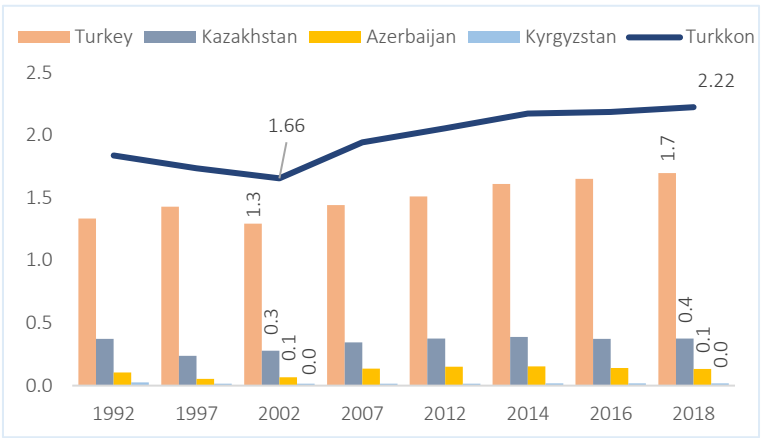
1 Economic Growth and Foreign Economic Relations

1.1 Production, Growth and Employment

The combined GDP of the Azerbaijan, Kazakhstan, Kyrgyzstan and Turkey was worth $990.1 billion in 2018, and represented 2.2% of the world economy. GDP of the Turkic Council Member Countries averaged $1,104 billion from 2010 until 2018, reaching highest point of $1,269 billion in 2013. In contrast to Turkey, whose share in the world economy was growing steadily, since 1992, shares of Azerbaijan, Kazakhstan and Kyrgyzstan in the global economy did not undergo significant changes (Figure 1.1). In 2018, Turkey accounted for 1.7% of the world GDP in PPP, Kazakhstan 0.38%, Azerbaijan 0.13% and Kyrgyzstan 0.02%.

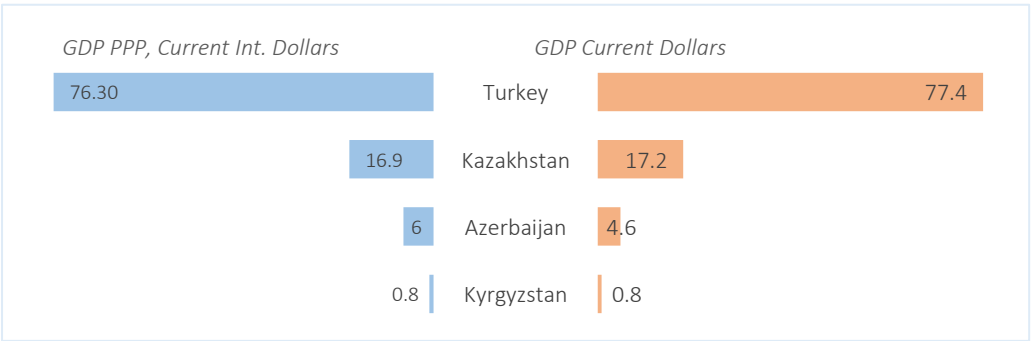
Turkey dominates within the combined GDP of the Turkic Council Member Countries (TC MCs), accounting for above three quarters or $766 billion of it in 2018. Near 17% of the total Turkic Council GDP belongs to Kazakhstan ($171 billion), 4.6% to Azerbaijan ($45 billion) and 0.8% to Kyrgyzstan ($8.1 billion). When ranked by PPP adjusted GDP, the picture is more or less the same (Figure 1.2).

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



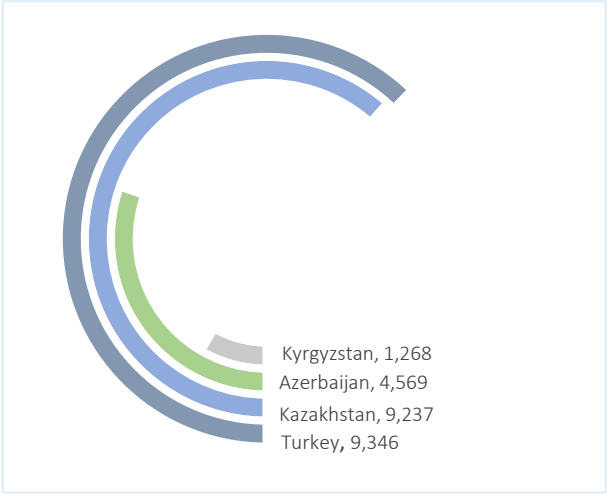
Source: IMF, World Economic Outlook database.

Figure 1.2: Shares in the Combined GDP of the Turkic Council Member States (2018, percent)



Source: IMF, World Economic Outlook database.

Figure 1.3: GDP per Capita (2018, current USD)



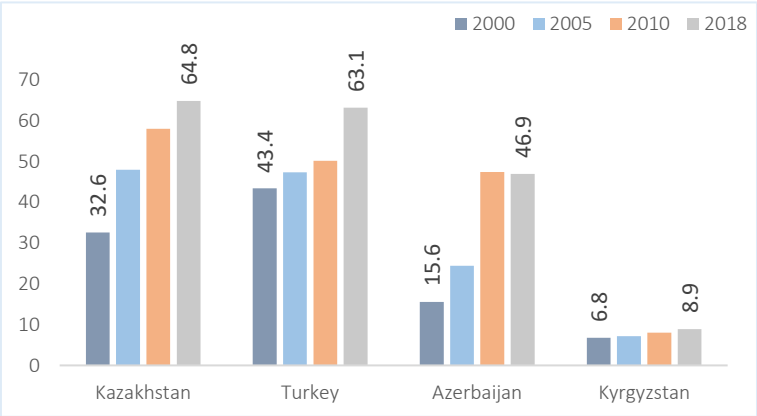
Source: IMF, World Economic Outlook database.

In 2018, Turkey recorded the highest level of GDP per capita among the TC MCs, at $9,346. With a very close figure to Turkey, $9,237 GDP per capita puts Kazakhstan at the second place, followed by Azerbaijan in the third place ($4,569). GDP per capita is significantly lower in Kyrgyzstan at $1,268, where near 26% of population is living below the national poverty lines, according to the World Bank data.

In order to better understand the level of prosperity of the TC MCs, the index of GDP per capita in PPP shown in Figure 1.4 is expressed in relation to the European Union average (EU-28), set to equal 100. If the index of a country is lower than 100, this country's level of GDP per capita is lower than the EU average and vice versa. In this regard, in 2018, PPP adjusted GDP per capita of the TC MCs ranged from 9% of the EU average in Kyrgyzstan, to 65% of the EU average in Kazakhstan. PPP adjusted GDP per capita is above 63% of the EU average in Turkey and 47% of the EU average in Azerbaijan.

It is interesting to note that in the period after 2013 the national currencies of the TC MCs, particularly of Azerbaijan, Kazakhstan and Turkey have rapidly lost the value against the dollar, and paved the way for the melting in the GDP values in current dollars of these countries, despite economic growth (Figure 1.5). In the case of Azerbaijan, main reason lies behind the insufficient diversification of the economy and the country's vulnerability to the volatility in energy output and prices. The eventual development of non-oil sectors would make the economy of Azerbaijan less vulnerable to commodity price volatility. The economy of Kazakhstan also suffers from external shocks, such as lower oil prices and the slow-down of key trading partners, particularly the recession in Russia.

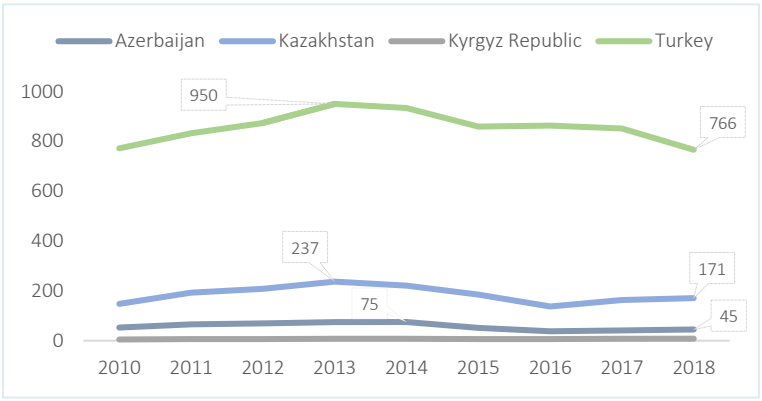
Figure 1.4: GDP per Capita (EU = 100, percent)



Source: IMF, World Economic Outlook database.
Notes: GDP based on PPP, constant prices, 2011 international dollars. The Figure is using average GDP per Capita of European Union as basis of comparsion at 100.

When it comes to Turkey, economic transformation and economic growth of this country was a source of inspiration for a number of developing economies. Rapid urbanizations, opening up to the world economy in 1980, introduction of structural and macroeconomic reforms including fiscal discipline in 2000s, independence of central bank, constantly growing internal market (supported with young population), dynamic private sector and predictability in the Turkish economy have all together contributed to steady growth of Turkish share in the world economy (see Figure 1.1). However, structural current-account deficit and the high level of foreign-currency denominated debt held by the private sector are increasing Turkey's external financing needs. In addition, current concerns over macroeconomic imbalances, a wave of tightening monetary policy in advanced economies, and existing geopolitical tensions, all led to rapid depreciation of the Turkish Lira, which caused for the Turkish GDP in current dollars to lost around 20% of its value from 2013 to 2018 (Figure 1.5).

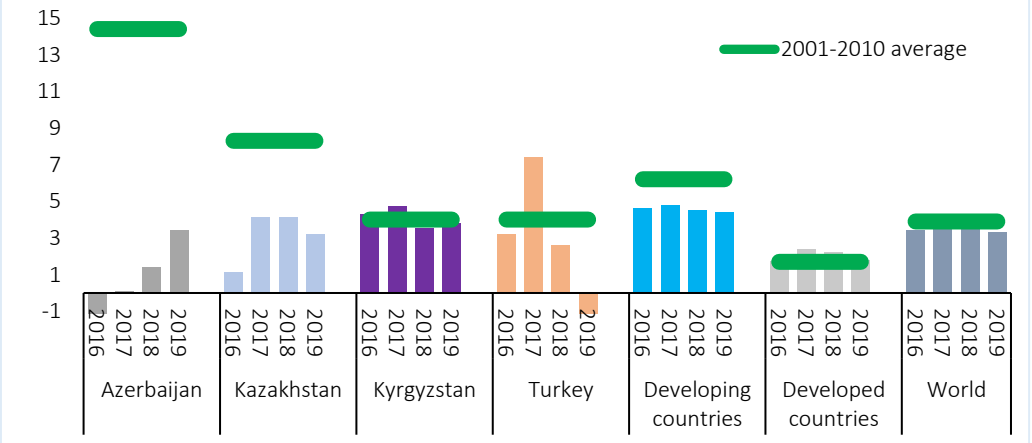
Figure 1.5: Gross Domestic Product (Billions of current USD)



Source: IMF, World Economic Outlook database.

Currently, the world economy is growing slower and substantial risks are arising. A synchronized global recovery that existed after 2016 lost its momentum and deceleration of growth is visible

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



Source: IMF, World Economic Outlook database.
Notes: Forecast for 2019 (Developing countries: N = 154; Developed countries: N = 39; World: N = 193)

now both in developed and developing countries, causing a slowdown in the world real GDP growth rate from 3.8% in 2017 to 3.6% in 2018. In the latest update of World Economic Outlook, the IMF forecasts that the global economy will further decrease to 3.2% in 2019, but it will be on track to stabilize towards 2020 (see Figure 1.1).

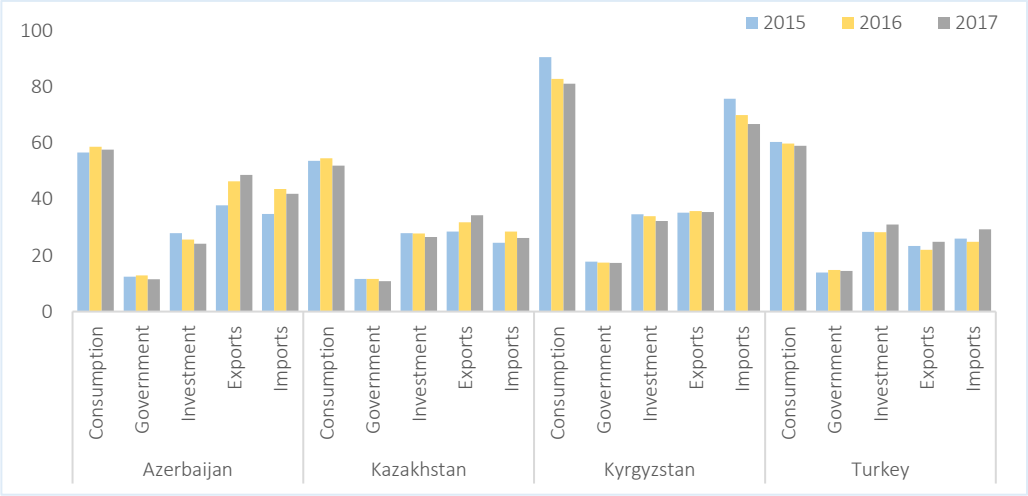
Real GDP growth figures for last three years continue to display stable growth momentum for the TC MCs, with the exception of Turkey. After the GDP decline in 2016 (-3.1%), Azerbaijan's economy escaped recession in 2017 with a symbolic growth rate of 0.1%. Supported by growth in the non-oil sector, output has continued to rise slowly in 2018, expanding the economy by 1.4%. Azerbaijan is projected to grow faster in 2019 at 3.4%, driven by firm oil prices and a continued recovery in private consumption. However, Azerbaijan will remain significantly below the average growth rates achieved in the period from 2001 to 2010 (Figure 1.6).

The Kazakh economy seems strong. Driven by oil output expansion and favourable commodity prices, the economy of Kazakhstan expanded at a rate of 4.1% in both 2017 and 2018, faster than the 1.1% achieved in 2016. It is projected for Kazakhstan economy to cool slightly to 3.2% in 2019.

Economic climate in Kyrgyz Republic remains relatively favourable, which grew 4.3% in 2016 and 4.7% in 2017, exceeding the country's average growth rate realized in the period from 2001 to 2010. Growth has moderated to 3.5% in 2018 due to a drop in gold production, which is expected to speed up to 3.8% in 2019.

Real GDP growth of Turkey accelerated sharply in 2017, to 7.4% (from 3.2% in 2016) owing to government stimulus measures, government credit guarantees to SMEs, improved export competitiveness and major public infrastructure projects. However, rapid depreciation of the Turkish Lira has exacerbated internal and external imbalances, and caused real GDP growth of Turkey to decelerate sharply in 2018 to 2.6%. IMF expects Turkey to close 2019 by negative growth rate of -2.5% (Figure 1.6).

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



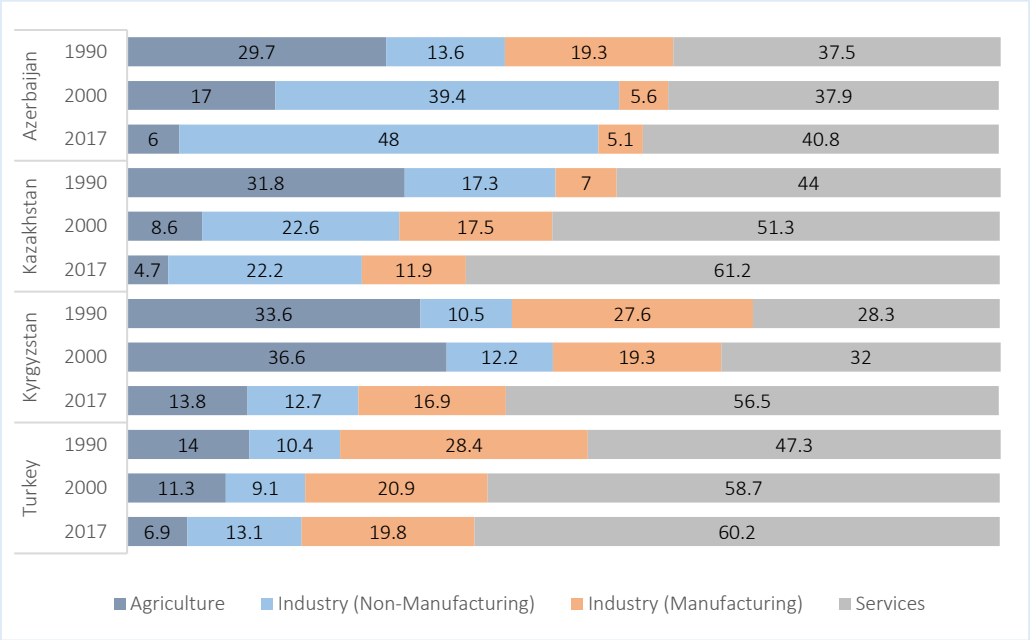
Source: World Bank, World Development Indicators.

In the period from 2015 to 2017, the contribution of real net exports to GDP growth was significant in Azerbaijan and Kazakhstan, while somewhat faster growth of domestic investments and general government consumption provided stimulus to Turkish economy. From 2016 to 2017 all the TC MCs have experienced slight decrease in private consumption and with the exception of Turkey, decrease in domestic investments. From 2016 to 2017, only in case of Turkey import volumes were growing faster than those of exports (Figure 1.7). On the supply side, the key weakness of the TC MCs is low or very low share of manufacturing. From 1990 to 2017 share of manufacturing in GDP has significantly fallen in Azerbaijan, Kyrgyzstan and Turkey (Figure 1.8). Non-manufacturing industry (particularly the extraction industry) is growing rapidly in Azerbaijan. The reforms should promote innovation in manufacturing, to improve efficiency and make production more environmentally friendly.

Agriculture's share in economies of the TC MCs has progressively declined to less than 7% in Azerbaijan, Kazakhstan and Turkey. However, the agriculture's importance in economic and social fabric of the TC MCs goes well beyond this indicator, due to food security dimension as well as many families being dependent on rural incomes. For example, according to the World Bank data, in 2017 25% of Turkey's population, 43% of Kazakhstan's population, 45% of Azerbaijan's population and 64% of Kyrgyzstan's population were living in rural areas. As shown in Figure 1.8, services sector account for most of the rise in GDP growth of the TC MCs.

Satellite images of Earth at night - often referred to as "night-lights", are a very appealing instrument to measure economic activity and economic growth of countries and cities. A large body of research shows that the brightness of a country's night-lights is highly correlated with

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



Source: UNSD National Accounts Main Aggregates Database.

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

Source: NASA Earth Observatory.

GDP growth. The more prosperity people have, the more likely they are to have lights on at night. Businesses will also stay open later, resulting in even more light.

Map 1.1 show night-lights of the TC MCs, as observed in 2012 and 2016, enabling for comparison of light sources in a given period. The first observation from these maps is a fact that Turkey is brighter lit by its cities, while the interiors of Kazakhstan and Kyrgyzstan remain dark and most probably sparsely populated. Second observation from Map 1.1 is a fact that from 2012 to 2016 more lights are beginning to appear in many parts of Turkey, and partly of Azerbaijan, pointing

Table 1.1: Luminosity Growth per Square Kilometer

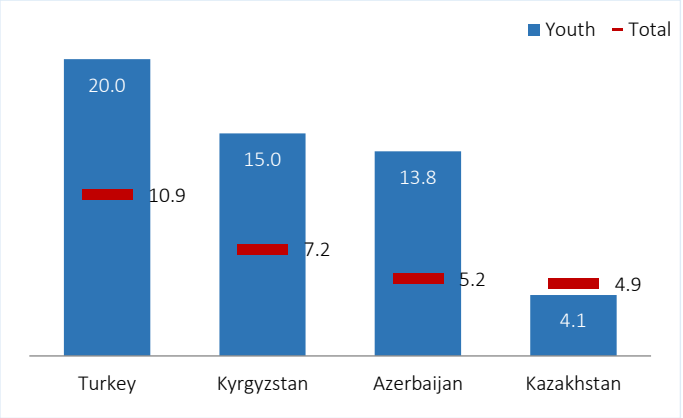
	1992 (area lit, km^2)	2002 (area lit, km^2)	2013 (area lit, km^2)	1992-2002 growth (%)	2002-2013 growth (%)	1992-2013 growth (%)
Turkey	8.46	9.08	10.02	7.4	10.3	18.5
Kazakhstan	8.61	8.63	9.23	0.3	6.9	7.2
Azerbaijan	6.78	7.04	7.59	3.8	7.8	12.0
Kyrgyzstan	5.80	6.08	6.59	4.8	8.5	13.7

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

out to the more inclusive growth process in these countries. In contrast to rest of the TC MCs, the number of regional economic centres in Turkey has increased and it became much more luminous. In the period from 1992 to 2013, luminosity growth per square kilometre was largest in Turkey (Table 1.1). Kyrgyzstan night-lights per square kilometre grew 13.7% in the same period. However, compared with the other TC MCs, actual pixel values per square kilometre are still lowest in Kyrgyzstan (Table 1.1).

In the TC MCs, economic growth continues to be largely disconnected from employment growth. From 2012 to 2018, despite real GDP growth, unemployment in Azerbaijan and Kazakhstan was almost stabilized at around 5%. In the same period, with contribution of expatriate working population the labour situation has improved in Kyrgyzstan, where total unemployment is reduced from 8.4% to 6.8%, while unemployment in Turkey rose from 8.2% in 2012 to 11% in 2018 (Figure 1.9). In Turkey, the employment growth is under shadow of increased number of people entering labour market, thus paving the way for unemployment to remain at higher levels. Skills mismatch is another key factor behind the high unemployment rates in Turkey. The International Labour Organization (ILO) projects that total unemployment rate of the TC MCs will increase slightly in 2019.

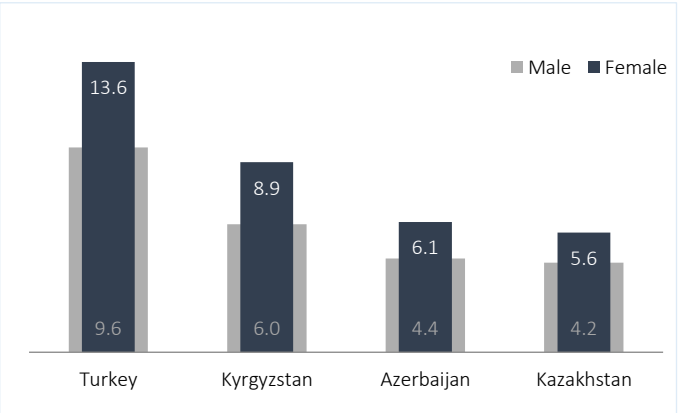
Figure 1.9: Unemployment (2018, percent)



Source: ILO modelled estimates.

The lack of employment opportunities for youth (i.e. those between 15-24 years of age) remains to be another major challenge of the TC MCs, with the exception of Kazakhstan. The challenge is particularly acute in Turkey, where 20% of young people in the labour market remained without a job in 2018. In the same year, youth unemployment rate in Azerbaijan was 13.8%, or

Figure 1.10: Unemployment by Gender (2018, percent)



Source: ILO modelled estimates.

Figure 1.11: Real Wage Growth (Annual change, percent)

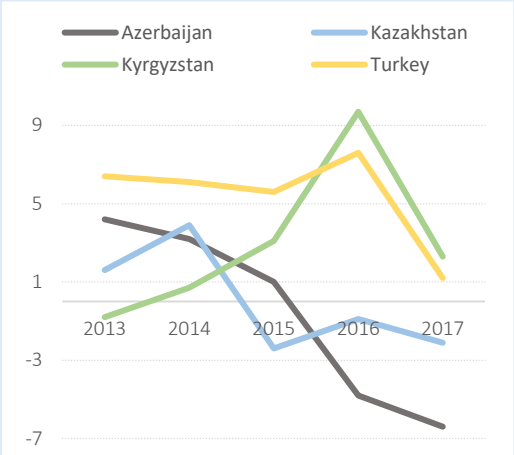
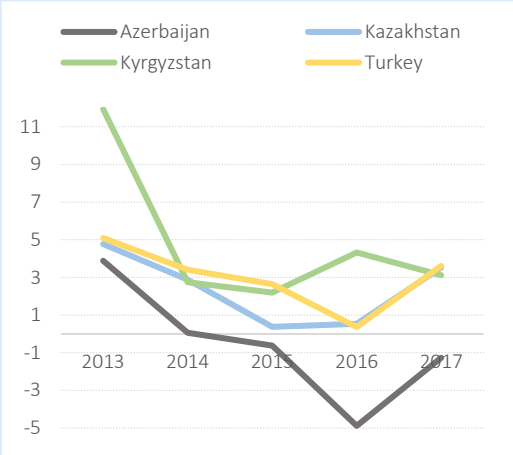


Figure 1.12: Labour Productivity Growth (Annual change, percent)



Source: ILO, *Global Wage Report 2018/19: What Lies Behind Gender Pay Gaps*, Geneva, International Labour Organization, 2018. *Note:* Labour productivity growth is calculated based on ILO modeled estimates on output per worker (GDP constant 2010 USD).

almost 2.7 times higher than total unemployment rate in this country (Figure 1.9).

Differences in unemployment rates between women and men in the TC MCs are relatively small. Still, it is obvious from Figure 1.10 that it is harder for women to find a job. In this regard, worse situation is observed in Turkey, where the unemployment rate of women for 2018 – at 13.6% – is 4 percentage points higher than the rate for men, according to the ILO modelled estimates.

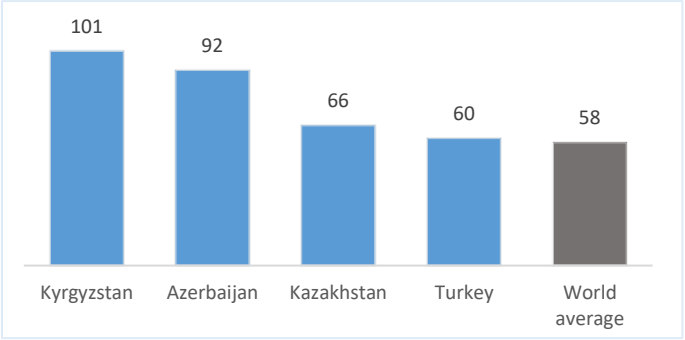
In Turkey, real wage growth and labour productivity growth fell gradually between 2013 and 2017, in spite of an acceleration in economic growth. Situation is more critical in Azerbaijan, which is facing both negative real wage growth and the negative labour productivity growth in the period after 2015. Slow productivity growth also explains the negative real wage growth rates in Kazakhstan in the same period. In Kyrgyzstan, real wage growth has increased from 3.1% in 2015 to 9.7% in 2016, then declined to about 1% in 2017. Nevertheless, it is visible from the comparison between Figure 1.11 and Figure 1.12 that on average, labour productivity in the TC MCs has increased more rapidly than real wages in the period from 2016 to 2017.

1.2 Foreign Trade in Goods and Services

One of the most important factors of economic development is foreign trade, and over the past two decades, the TC MCs have benefited significantly from increased integration into the global economy. As it is shown in Figure 1.13, in 2018 all Member States had trade-to-GDP ratios over the world average.

Trade represented 92% of Azerbaijan's GDP in 2018 (Figure 1.13), when the country recorded a trade surplus of $7.8 billion. Moreover, balance of trade in Azerbaijan averaged $10.4 billion from 2011 until 2018, reaching highest score of $21.2 billion in 2011 (Figure 1.14). Azerbaijan's total foreign trade turnover in 2018 was $43.2 billion (an increase of 14.5% compared to 2017) and its exports accounted $25.5 billion (Figure 1.14). The share of the oil/gas sector in top five export items of Azerbaijan was 88.9% in 2017, making the country highly vulnerable to the global energy prices (Figure 1.15).

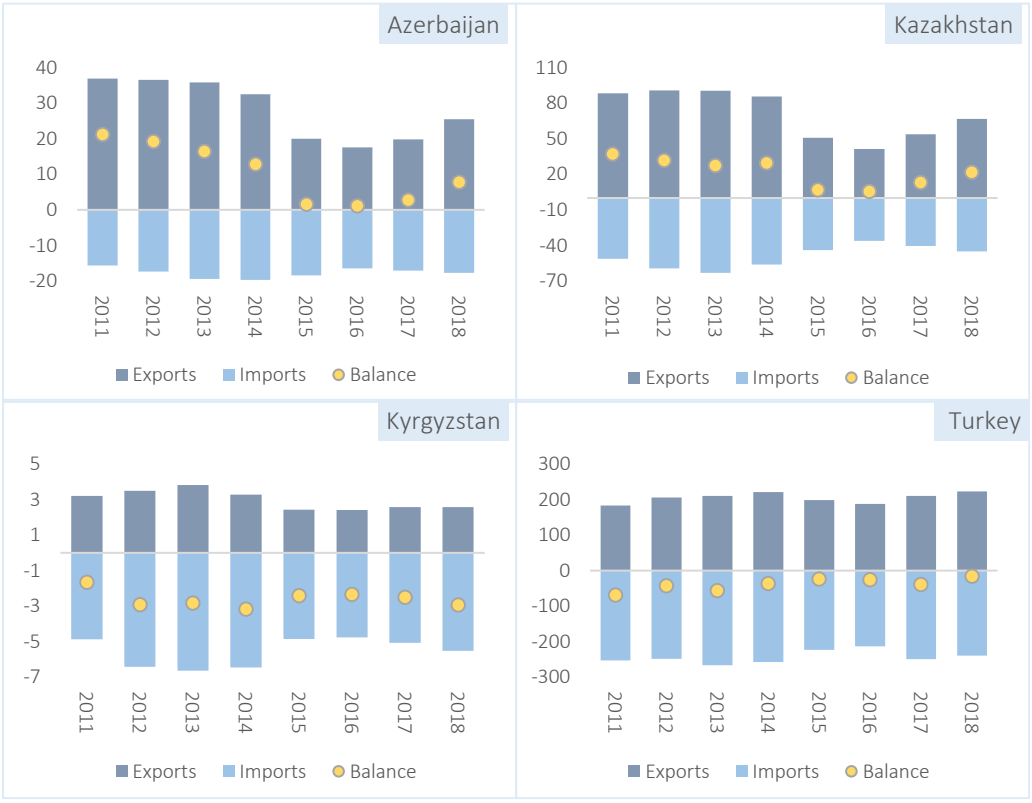
Figure 1.13: Total Trade as Percent of GDP (2018)



Source: World Bank

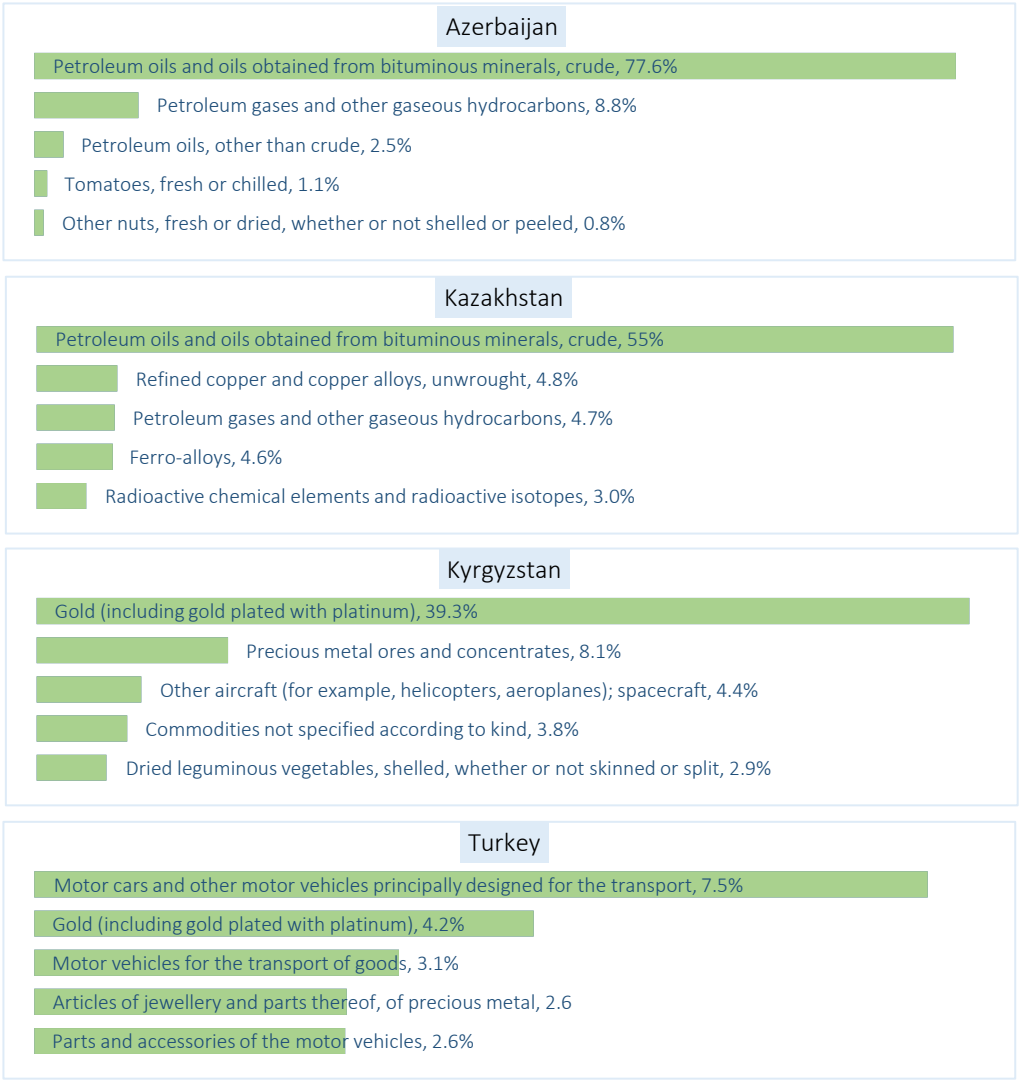
Kazakhstan is one of the biggest landlocked nations in the world. Strategically, however, Kazakhstan is located in the heart of Eurasia at the intersection of transport and communication

Figure 1.14: Total Trade Balance (Current USD, billion)



Source: UNCTADSTAT.

Figure 1.15: Top Five Export Items (2017)



Source: UN DESA, 2017 International Trade Statistics Yearbook, Volume 1, Department of Economic and Social Affairs of the United Nations Secretariat, 2019.

lines connecting the large and fast growing markets of China and South Asia and those of Russia and Western Europe. Together with Kyrgyzstan, Kazakhstan is the member state of the Eurasian Economic Union (EAEU) - a limited customs union.

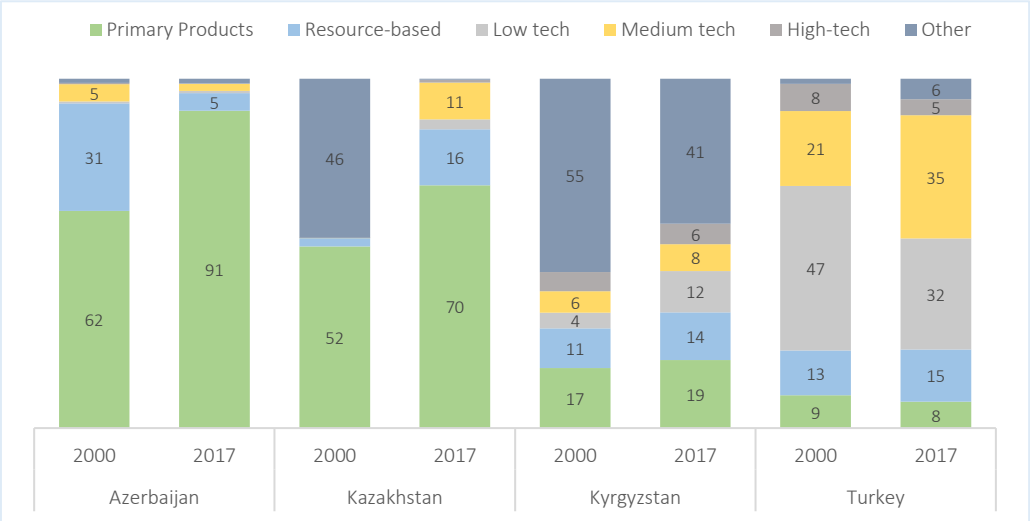
In 2018, the combined value of exports and imports of Kazakhstan was equal to 66% of GDP (Figure 1.13). In the same year, Kazakhstan exported $66.9 billion and imported $45.1 billion, resulting in a positive trade balance of $21.7 billion (Figure 1.14). In the period from 2012 to 2016, the exports of Kazakhstan have decreased constantly, recording values from $91 billion in 2012 to $41.5 billion in 2016. The share of the oil/gas sector in top five export items of Kazakhstan was near 60% in 2017.

Kyrgyzstan had a total export of $2.6 billion and total imports of $5.5 billion leading to a negative trade balance of $2.9 billion in 2018 (Figure 1.14). A reliance upon energy and value added imports explains the significant trade deficit that exits over the years. The export in 2017 was led by gold, which represented 39.3% of the total exports of Kyrgyzstan, followed by precious metal ores, which accounted for 8.1% (Figure 1.15). Low level of product diversification and reliance upon natural resources makes the economy of Kyrgyzstan susceptible to volatile commodity prices.

Turkey's total foreign trade turnover in 2018 was $463.1 billion, what makes it biggest trading nation among the TC MCs. Turkish exports rose by 5.9% in 2018 to hit $223.4 billion, while imports totalled $239.7 billion. Turkey's trade deficit has declined to $16.3 billion in 2018, from $39bn in 2017. In general, Turkish trade deficit stems from strong domestic demand and rising global energy prices. Turkey is the only TC MC whose top exports evolved from mainly labour intensive and unprocessed agricultural products such as nuts, cotton and tobacco in 1980 to mid-tech goods such as automobiles, white goods and mechanical machinery by 2017 (Figure 1.16). Furthermore, Turkey's export basket also diversified during this period, with the share of top five products decreasing from 51% to 20% in the same period.

As can be followed from the Figure 1.16, in 2017 96% of export basket of Azerbaijan and 86% of exports basket of Kazakhstan were primary products and resource-based products. In the same year, share of medium-tech products in the export basket of Turkey was 35%, while the same data for Kazakhstan, Kyrgyzstan and Azerbaijan remained at 11%, 8% and 2% respectively. From this, it can be concluded that with the exception of Turkey, the TC MCs are not among innovative economies. Moreover, even Turkey have to prepare its institutions, infrastructure, companies and human capital to make the jump from low and mid-tech to high-tech.

Figure 1.16: Export Sophistication (2000, 2017, percent)



Source: UN Comtrade, SESRIC calculations at SITC Rev. 2 at 3 digit level.
Notes: Other category includes electricity, cinematographics film, printed matter, special transactions, gold, coins, pets and works of art.

Table 1.2: Top Five Export and Import Partners (2018)

Top Five Export Partners		Top Five Import Partners
Share		Share
Italy (30%), Turkey (9%), Israel (7%), Czech Republic (5%), India (4%)	Azerbaijan	*Russia (16%), Turkey (14%), China, P.R.: Mainland (10%), Germany (6%) United States (5%)*
Italy (19%), China, P.R.: Mainland (10%), Netherlands (10%), Russia (8%), France 6%)	Kazakhstan	*Russia (37%), China, P.R.: Mainland (17%), Germany (5%), United States (5%), Italy (5%)*
United Kingdom (40%), Russia (16%), Kazakhstan (13%), Uzbekistan (9%) Turkey (6%)	Kyrgyzstan	*China, P.R.: Mainland (40%), Russia (25%), Kazakhstan (10%), Turkey (6%), Uzbekistan (4%)*
Germany (10%), United Kingdom (7%), Italy (6%), Iraq (5%), United States (5%)	Turkey	*Russia (10%), China, P.R.: Mainland (9%), Germany (9%), United States (6%), Italy (5%)*

Source: IMF DOTS.

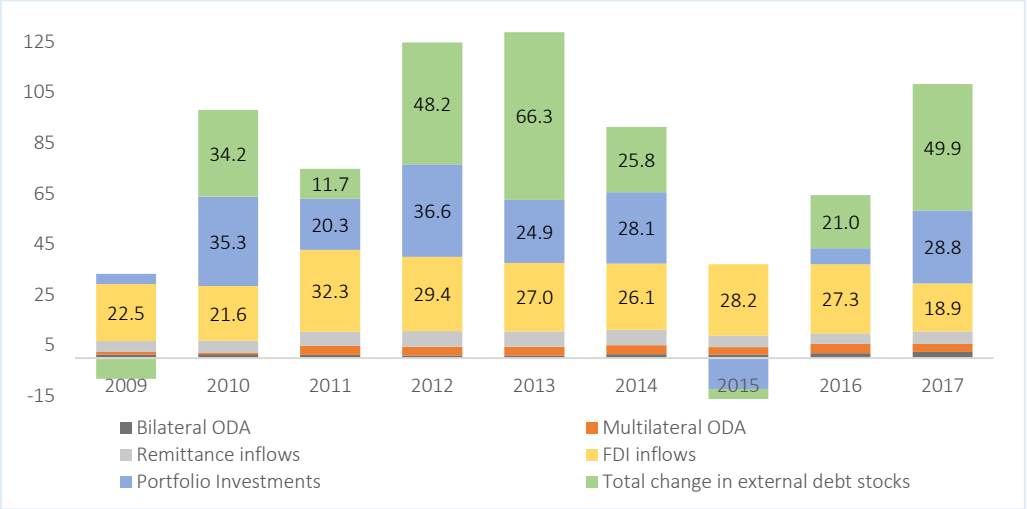
Table 1.2 illustrates that EU Member States, China and Russia are among the main trading partners of the TC MCs. In 2018, Russia was number one partner for imports of Azerbaijan, Kazakhstan and Turkey, while China was second largest import destination for almost all the TC MCs. On the export side, in the same year, European markets were dominating as a destination for exports of the TC MCs. It should be said in this context that the TC MCs remain to be highly reliant on the growth trends in the EU Member States, China and Russia.

1.3 External Financing Flows for Development

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

The international development cooperation has always played an important role in supporting and boosting the economic development. Conventional practice has been to treat development cooperation narrowly as the Official Development Assistance (ODA) provided by the member countries of the OECD's Development Assistance Committee (DAC). But given the growing gap between the demand for resources in developing countries and the flow of resources from provider countries, foreign aid is not enough, and mobilizing additional resources for development as well as increasing the effectiveness of existing resources has become more pertinent than ever. As can be seen from Figure 1.17, international actors, both public and private, contribute substantive amounts of cross-border finance to the TC MCs.

Figure 1.17: External Financing Flows to the Turkic Council Member States by Sources (Current prices, billion USD)

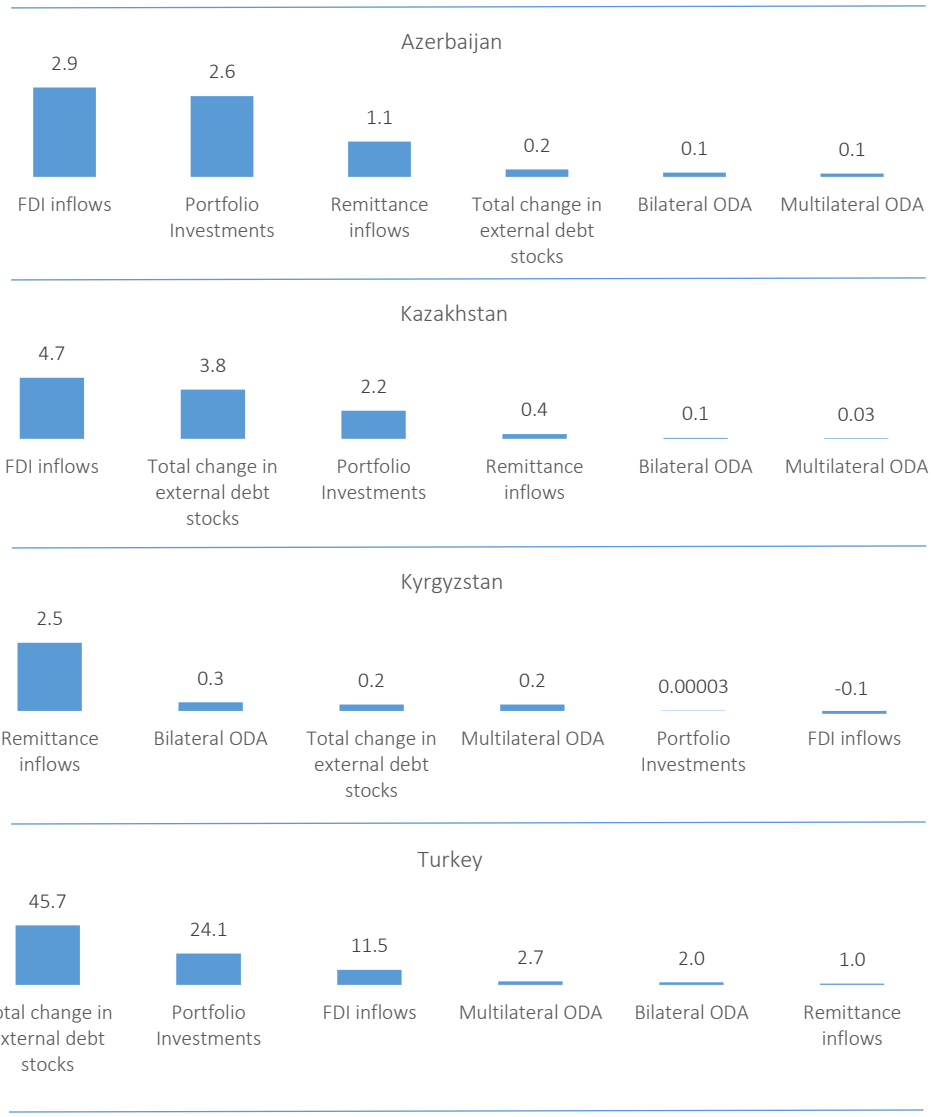


Source: Author's calculations based on OECD "Creditor Reporting System" database for official bilateral and multilateral gross disbursements flows (Bilateral ODA flows are calculated based on 29 DAC countries and 20 Non-DAC countries that are reporting to the OECD); World Bank "Migration and Remittances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

Compared to 2015, the volume of external finance available to the TC MCs has substantially increased to $108.3 billion in 2017 (Figure 1.17). Near 80% of this amount ($87 billion) went to Turkey, 10% to Kazakhstan ($11.1 billion), 7% to Azerbaijan ($7.1 billion) and 3% or $3.2 billion to Kyrgyzstan (Figure 1.18). Figure 1.17 witness the change in the global landscape of foreign aid, where increased volumes of foreign direct investments (FDIs), cross-border remittances, loans and other commercial interactions have reduced the significance of foreign aid (ODA) in relative terms. At $5.6 billion in 2017, the total of bilateral and multilateral ODA flows to the TC MCs represents an important but small proportion of the external financial flows. While the proportion of total ODA declined to around 5% of total external finance transfers to the TC MCs in 2017, it continues to provide critical inputs for the central government expense in Kyrgyzstan. According to the World Bank data, in 2017 net ODA received as percent of central government expense accounted for 23% in Kyrgyzstan, 1.2% in Turkey, 1% in Azerbaijan and 0.2% in Kazakhstan.

It is interesting to note that in 2017, 84% of the total bilateral and multilateral ODA flows to the TC MCs has gone to Turkey. In general, ODA flows to Turkey were directed to Syrian refugees. Still, present ODA figures shows that Turkey enjoys a status of both, ODA provider and ODA recipient country. According to the OECD data, Turkey has provided $8.4 billion (gross disbursements) of ODA in 2017 in current USD, and again, most of this amount was spent for the refugees in Turkey. In same year, Kazakhstan has provided $23.5 million and Azerbaijan $5.4 million of foreign aid to other developing countries.

Figure 1.18: Shares in External Financing by Countries (2017, percent)

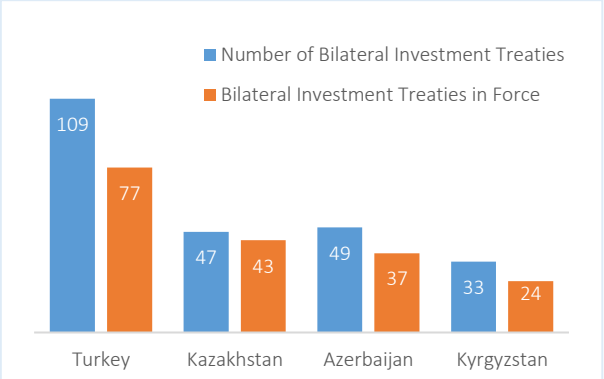


Source: Author's calculations based on databases listed in the source of Figure 1.18

As it is shown at Figure 1.18, remittance inflows to the TC MCs - money or other assets that migrants send to individuals in their home countries - have reached a $5 billion in 2017. This is an 18% increase from 2016, when the amount was $4.1 billion. It should be noted that remittance inflows were largest source of external finance for Kyrgyzstan in 2017, reaching a record high of near $2.5 billion. The World Bank has estimated that due to limited economic opportunities, in 2017 near 13% of population (782,000 people) of Kyrgyzstan was working abroad. The money labour migrants send back home to support their families in 2017 amounted to near one-third (32%) of the Kyrgyzstan's GDP - one of the highest rates in the world.

FDIs remain to be critical external source of finance for the TC MCs. Compared to portfolio investments, FDIs provide also a more stable stream and in 2017, they had the biggest share within the total external sources of finance in Azerbaijan and Kazakhstan (Figure 1.18). There appears to be awareness among the governments of the TC MCs, particularly in Turkey, that entering into binding international investment agreements is important for attraction of FDIs and stimulating growth (Figure 1.19).

Figure 1.19: Number of Bilateral Investment Treaties Concluded by the Turkic Council Member States (as of July 2019)



Source: UNCTAD, Investment Policy Hub.

In contrast to remittances and FDIs, portfolio investments and external debt flows appear to be more vulnerable to global conditions, particularly global interest rates. Still, portfolio investments to the TC MCs peaked at $28.8 billion in 2017, surpassing the FDI inflows to the TC MCs in the same year for near 34% (Figure 1.18). However, the increase in external debt flows is evident for 2017, what calls on the governments of the TC MCs to address the challenges linked to debt sustainability in order to prevent negative impact on long-term development.

PART II: International Trade among Turkic Council Member Countries

This Part includes the following chapters:

2 Current Trends in Cross-Border Trade

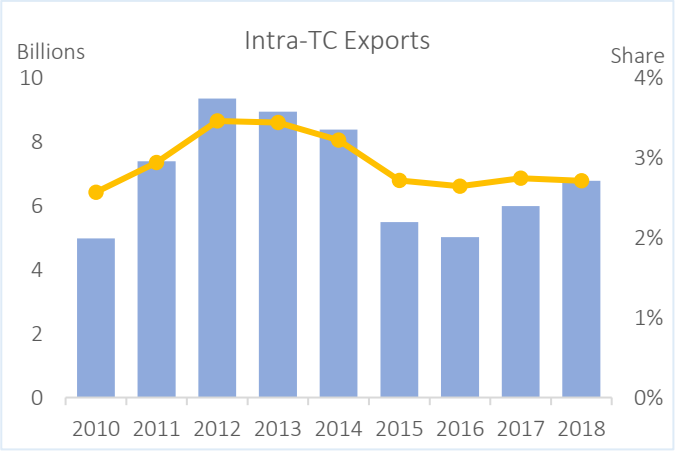
The member countries of the Turkic Council place great importance on enhancing economic cooperation among them. They identified the "Economic Cooperation" as the main theme of the First Summit of the Turkic Council that was held in Almaty, Kazakhstan on 20-21 October 2011. In this context, economic cooperation remained at the heart of the actual cooperation mechanisms of the Turkic Council, which are managed by the regular meetings of Ministers in charge of Economy. The actions taken to facilitate cross-border trade has resulted in a growing trade relationships among the TC MCs. However, various obstacles remain to hinder the growth of trade, such as lack of connectivity, burdensome custom procedures, lack of harmonized regulations and absence of proper business information centres, and competence and quality of logistics services. This chapter reviews the current trends in cross-border trade at national and sectoral levels among the TC MCs by utilizing international data sources. This exercise provides important insights on the trade patterns and trade structure among the member countries, and facilitate in-depth analyses in the following chapters.

2.1 Intra-regional Trade

Total exports among the TC MCs reached its highest level in 2012 by exceeding USD 9.3 billion. Over the following four years, it constantly fell to reach USD 5 billion in 2016. Since then, an upward trend has been observed in total intra-TC exports, which is recorded almost USD 6.8 billion in 2018 (Figure 2.1). The share of intra-TC export in total exports of the member countries declined from 3.5% in 2012 to 2.6% in 2016 and slightly increased to 2.7% in 2017. A similar trend is observed in the share of intra-TC trade (the share of intra-TC exports and imports in total exports and imports of the member countries). After declining from 2.7% in 2012 to 2.2% in 2015, the share of intra-TC trade remained fairly stable over the last four years and recorded at 2.3% in 2018 (Figure 2.2). Considering the 2.2% share of TC MCs in global GDP (see Chapter 1), the collective share of TC MCs in global trade fairly represents their economic contribution to global economy.

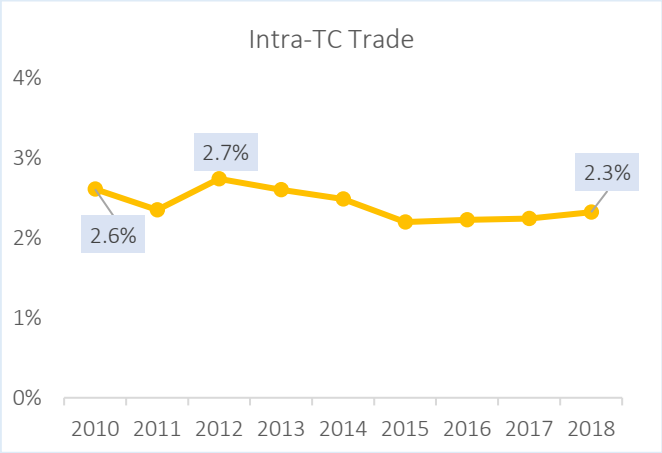
The size and development levels of TC MCs are not homogeneous. Turkey is the largest economy and accounts for more than three quarter of the total

Figure 2.1: Intra-TC Exports (2010-2018)



Source: SESRIC staff calculations based on IMF DOT database.

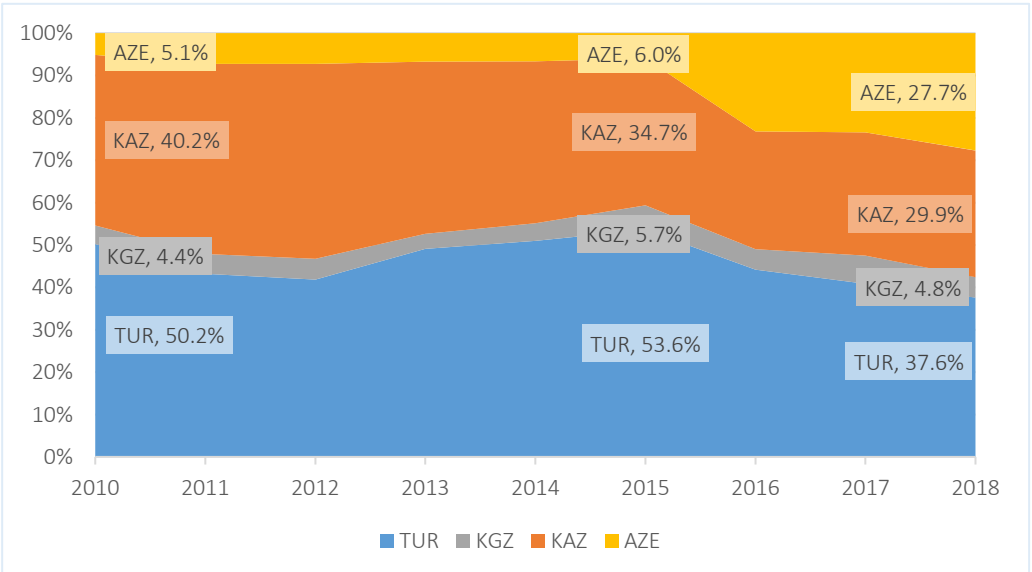
Figure 2.2: Share of Intra-TC Trade (2010-2018)



Source: SESRIC staff calculations based on IMF DOT database.

production of the region. On the other hand, Kyrgyz Republic has a less than 1% share in total. Since there are only four members of the TC with different economic sizes, a single economy has potential to affect the group totals and averages significantly. An economic boom or decline in a member country can result in a sharp rise or fall in group values. In this connection, Figure 2.3 shows the shares of individual member countries in intra-regional trade. It is observed that Turkey and Kazakhstan were accounting around 90% of all intra-TC trade until 2016, while Azerbaijan and Kyrgyz Republic were each accounting around 4-6% over the same period. Therefore, independent from global economic developments, economic developments in Turkey and Kazakhstan had greater likelihood of affecting total intra-TC trade flows. However, Azerbaijan expanded its trade relations with all other TC MCs since 2016 and started to account greater share of intra-TC trade. As of 2018, Azerbaijan accounts for 27.7% of total intra-TC trade, while the shares of Turkey and Kazakhstan declined to 37.6% and 29.9%, respectively.

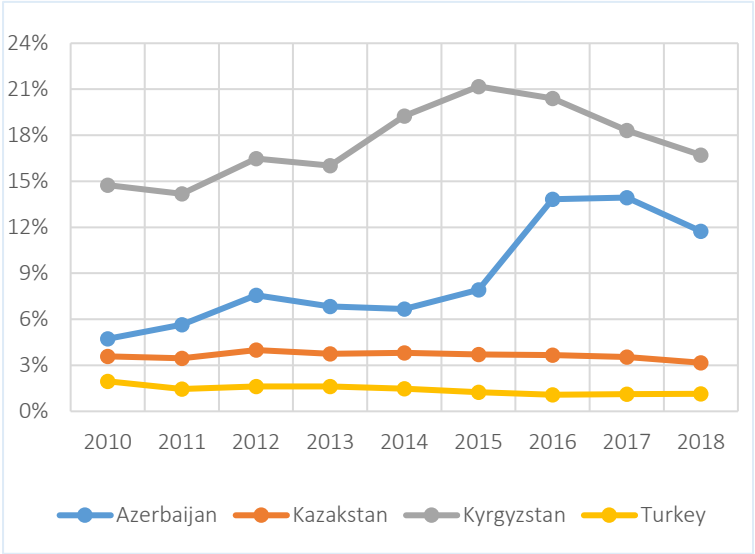
Figure 2.3: Share of MCs in Total Intra-TC Exports



Source: SESRIC staff calculations based on IMF DOT database.

An important indicator in analysing the bilateral integration within the TC region is the share of trade with other member countries. Despite the fall over the last three years, Kyrgyz Republic still has the highest share of trade with other TC MCs in 2018 with 16.7% share. It is followed by Azerbaijan (11.7%) and Kazakhstan (3.2%). Although Turkey has the largest share in intra-TC trade, its share in total trade of the country is only 1.1%. On average, intra-TC trade plays increasingly greater importance in Azerbaijan's and Kyrgyzstan's trade over time, but lesser importance in Turkey's and Kazakhstan's trade (Figure 2.4).

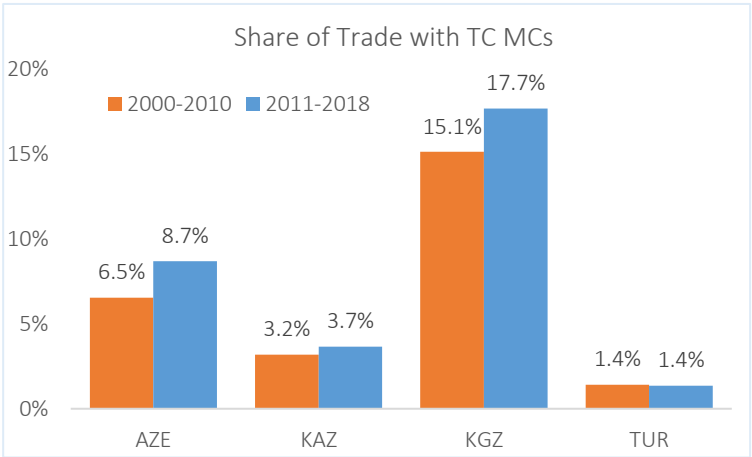
Figure 2.4: Share of Trade with TC MCs



Source: SESRIC staff calculations based on IMF DOT database.

When aggregated over the years since the establishment of the TC in 2011, it is observed that Kyrgyzstan, with a rate of 17.7%, had an average share of trade with other TC MCs that is much higher than other member countries. For Azerbaijan, TC MCs constitute important trade partners as they account for 8.7% of its total trade volumes. The share of trade with other TC MCs is relatively lower for Kazakhstan (3.7%) and Turkey (1.4%). Perhaps more importantly, it is promising to observe that average shares of trade with TC MCs have considerably increased when compared to the period average between 2000 and 2010. Only in the case of Turkey, it is observed that the relative importance of trade relations with TC MCs has marginally decreased (Figure 2.5).

Figure 2.5: Share of Trade with Other TC MCs



Source: SESRIC staff calculations based on IMF DOT database.

Figure 2.6a: Azerbaijan's Trade Partners 2010 vs 2018

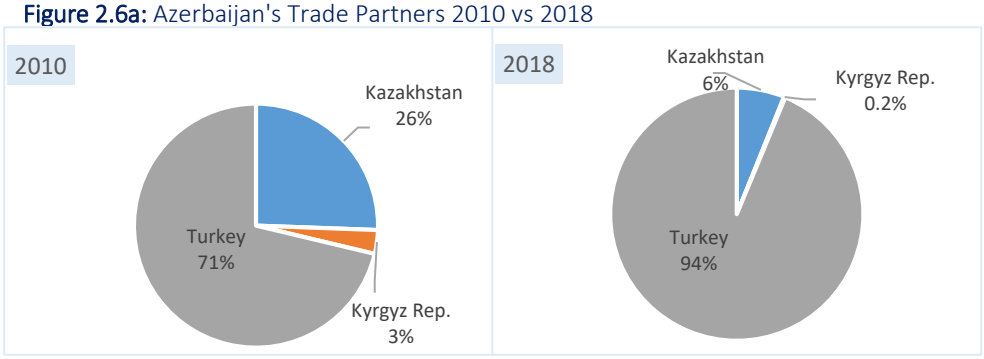


Figure 2.6b: Kazakhstan's Trade Partners 2010 vs 2018

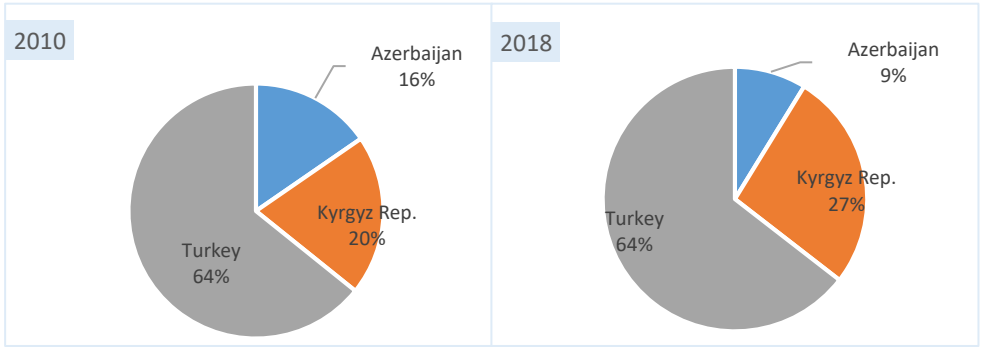


Figure 2.6c: Kyrgyzstan's Trade Partners 2010 vs 2018

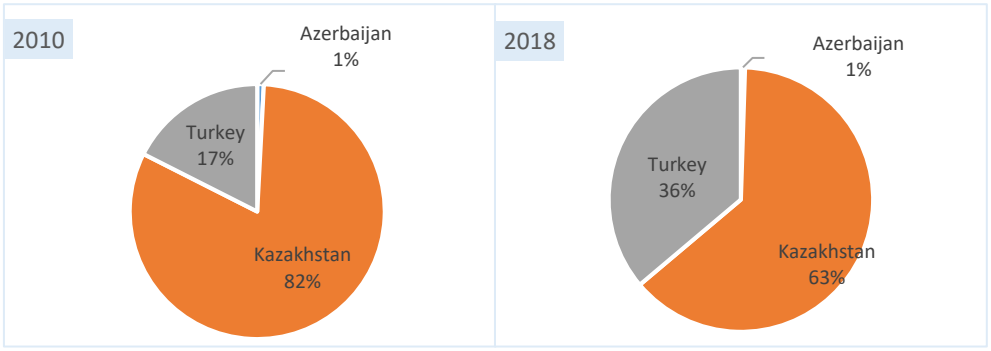
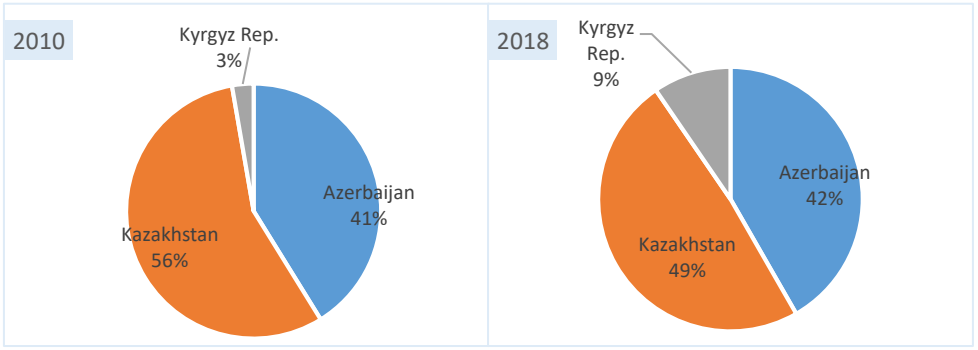
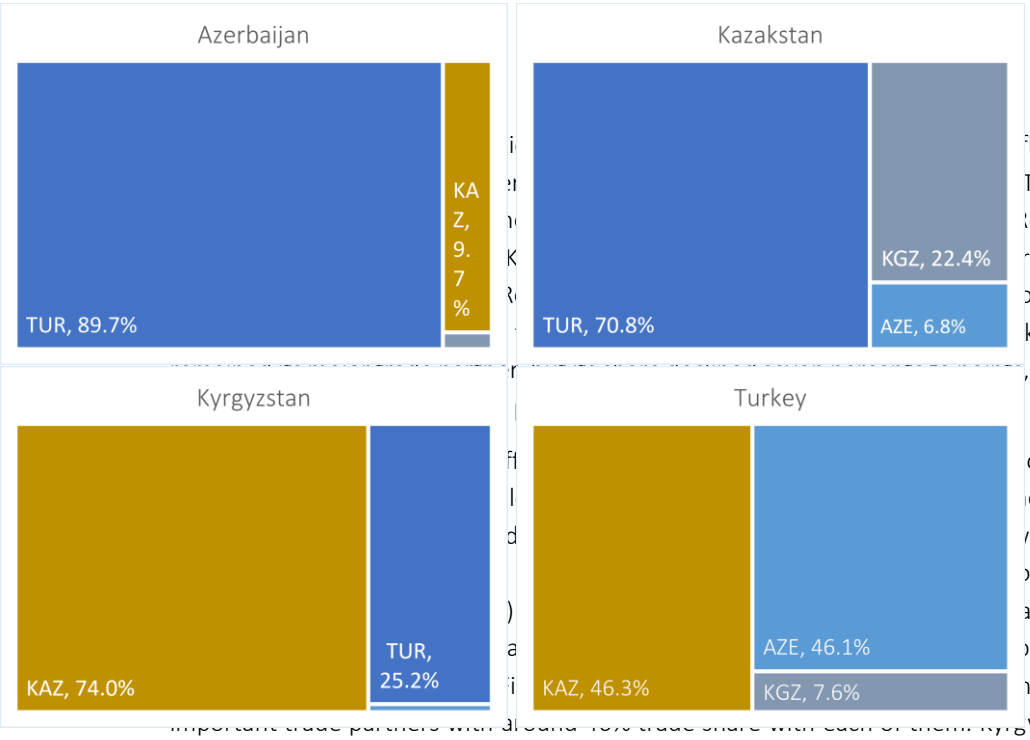


Figure 2.6d: Turkey's Trade Partners 2010 vs 2018



Source: SESRIC staff calculations based on IMF DOT database.



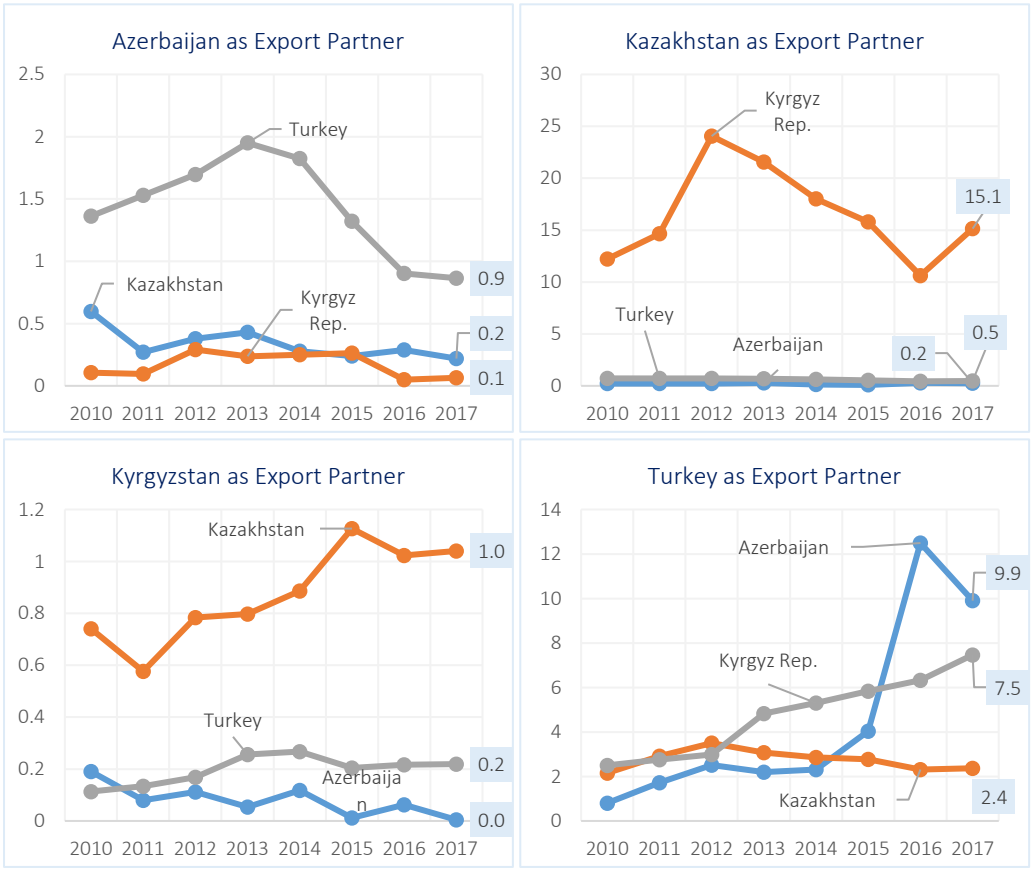
lows. Figure 2.6 Turkey has been epublic became rbaijan over the ons substantially key, Kazakhstan , while the share of trade volume e period under ith almost 90% ver 70% share, azakhstan is the le share in total nd out as equally yzstan accounts for 7.6% of Turkey's trade with TC MCs (Figure 2.7).

It can be argued that trade relations between Turkey and other TC MCs are strong, but further improvements would be needed to improve the relations between Azerbaijan and Kyrgyzstan as

Figure 2.7: Distribution of Trade with Other TC MCs (2011-2018)

Source: SESRIC staff calculations based on IMF DOT database.

Figure 2.8: TC MCs as Export Partners



Source: SESRIC staff calculations based on UN COMTRADE Database.

well as Azerbaijan and Kazakhstan. More discussion on how to facilitate trade among the member countries of the TC will be provided in the next chapters.

Before proceeding to sectoral and product level analyses, it is also illuminating to see relative importance of individual TC MCs as an export partner of other member countries in their exports to the world. Figure 2.8 reveals that Azerbaijan does not appear to be a major export partner for Kazakhstan and Kyrgyzstan, but it is a relatively more important market for Turkey's export products, albeit at decreasing rates. Kazakhstan is a major destination for Kyrgyz exporters with a share of around 15%, but does not constitute a major destination for other member countries. The case of Kyrgyzstan resembles to the case of Azerbaijan, where only one country (Kazakhstan) export as much as 1% of its export products to Kyrgyzstan, while this number is much lower for Turkey and Azerbaijan. On the other hand, Turkey is an important market for Azerbaijan and Kyrgyzstan, where 9.9% and 7.5% of their exports, respectively, reached to Turkey in 2017. On the contrary, Turkey becomes increasingly less attractive for Kazakh exporters.

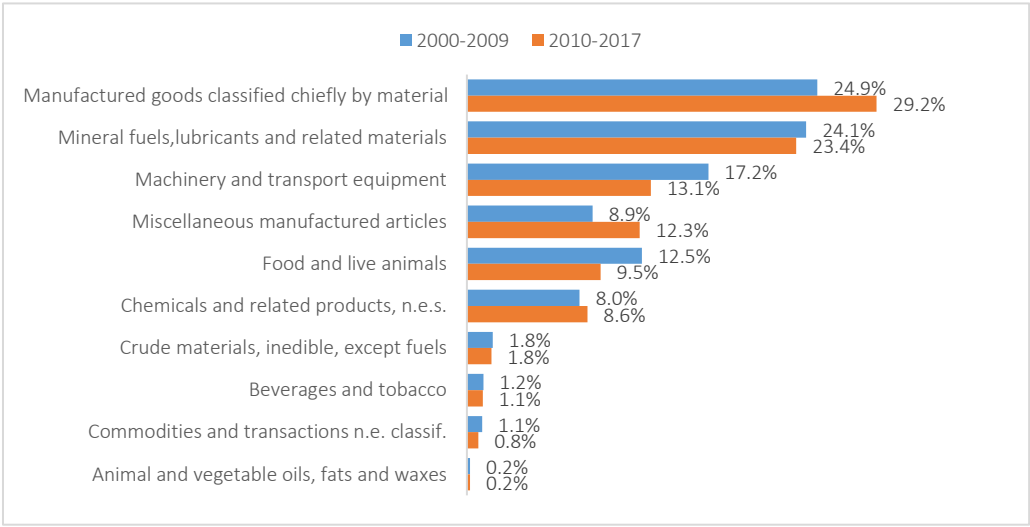
2.2 Trade Patterns at Sectoral and Commodity Level

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

In order to avoid annual fluctuations and to give a broader picture of the distribution of trade at sectoral level (classified according to SITC at two-digit level), the averages are calculated for the period between 2000-2009 and 2010-2017 to compare the changes over the last decade (Figure 2.9). Manufactured goods had the highest share during 2000's and, with a share of 29.2%, it became an even more important sector in trade relations among the TC MCs. The second most important sector is mineral fuels, lubricants and related materials. Particularly Azerbaijan and Kazakhstan are rich in natural resources and these resources constitute a significant share of their exports. During 2010's, mineral fuels accounted for 23.4% of total intra-TC trade. The third important sector is machinery and transport equipment, whose share is however declined from 17.2% to 13.1%. Similarly, the share of food and animals declined from 12.5% to 9.5% and become the fifth largest sector in intra-TC trade. On the other hand, the share of miscellaneous manufactured articles increased from 8.9% to 12.3% and become the fourth largest sector.

While Figure 2.9 shows average shares of sectors over almost two decades, Figure 2.10 shows the latest distribution of trade among the TC MCs. Although around a quarter of trade data is not classified yet, the Figure still provides important insights. Machinery and transport equipment constitute the bulk of trade among TC MCs. It is followed by manufactured goods classified chiefly

Figure 2.9: Sectoral Trade among TC MCs(2010-2017)



Source: SESRIC staff calculations based on UN COMTRADE Database SITC2 classification.

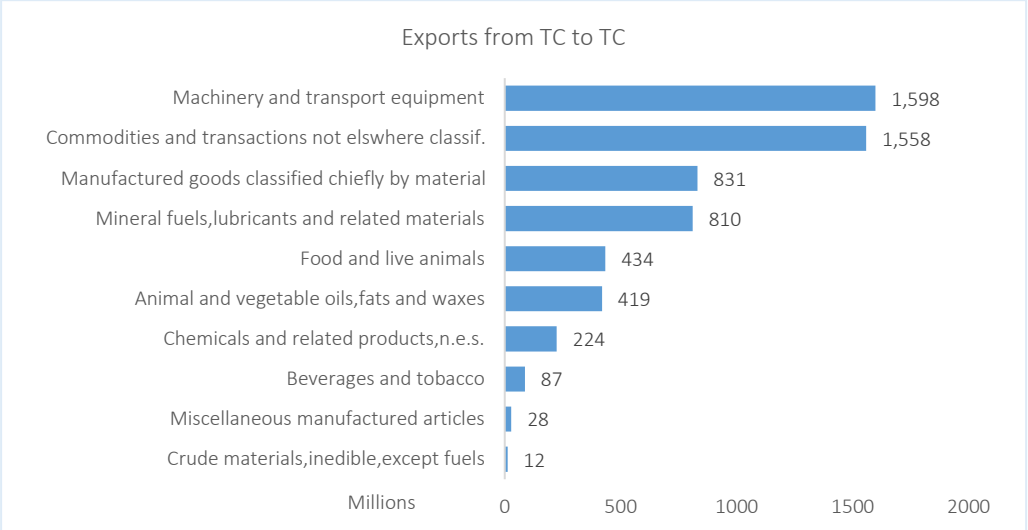
by material (USD 831 million) and mineral fuels, lubricants and related materials (USD 810 billion). Diverging considerably from the decade-long averages, animal and vegetable oils, fats and waxes accounted for almost 7% of total trade among TC MCs in 2017.

Member Countries of the Turkic Council have different mix of resources and level of development that shape their trade patterns. In order to provide more insights on the structure of bilateral trade, top 5 products that are exported by each member country to other member countries are calculated by using International Trade Centre Trade Map Database. Azerbaijan's export to Turkey is heavily concentrated on mineral fuels, oils and their products (Figure 2.11a). Since Turkey is the main export partner of Azerbaijan within the TC region, it is fair to say that Azerbaijan's export to TC region is based mostly on natural resources. Azerbaijan's export to Kazakhstan is similarly concentrated on a single product, which is articles of iron or steel.

Exports from Kazakhstan to other TC MCs reveal less concentration. Exports to Azerbaijan constitute mainly cereals (USD 54 million) and mineral fuels (USD 51 million). Exports to Kyrgyzstan are relatively more concentrated where mineral fuels account for bulk of the exports from Kazakhstan with USD 181 million. Turkey is again an important market for mineral fuels from Kazakhstan with more than USD 1.2 billion worth of exports in 2018. Other major export items are also mainly resource-based products, such as copper, aluminium and zinc (Figure 2.11b).

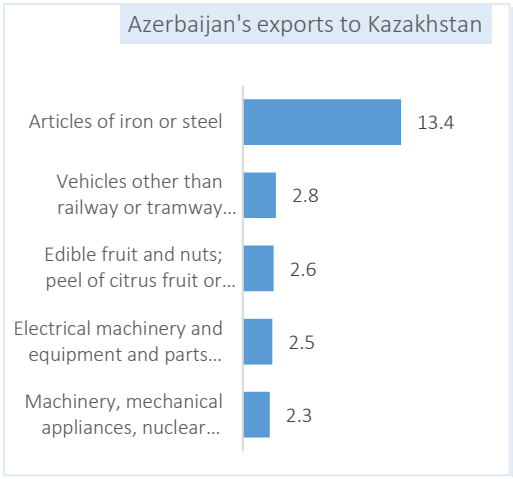
Trade relations of Kyrgyzstan with other TC MCs are shaped by product complementarities. As a resource-scarce country, exports products are not concentrated in a few products. While its exports to Azerbaijan mainly constitutes electrical machinery and equipment (USD 1.1 million), ores, slag and ash account for bulk of the exports to Kazakhstan (USD 97.7 million). As in the case of Azerbaijan and Kazakhstan, Turkey imports mainly mineral fuels from Kyrgyzstan (USD 33.5 million). Aircraft parts, vegetables and cotton are other exports items sold by Kyrgyzstan to Turkey in 2018 (Figure 2.11c).

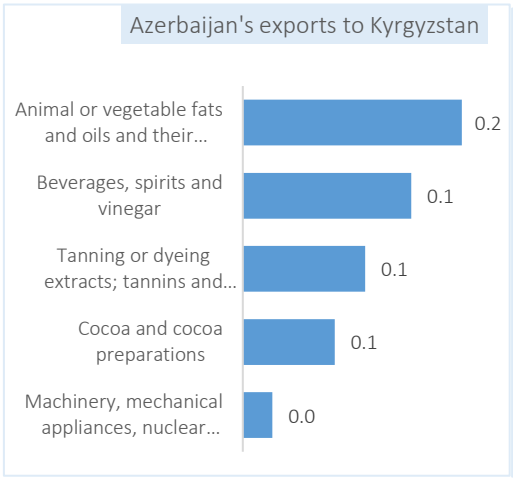
Figure 2.10: Sectoral Trade among TC MCs (2017)



Source: SESRIC staff calculations based on UN COMTRADE Database SITC2 classification.

Figure 2.11a: Azerbaijcan's Export to Other TC MCs - Top 5 Products (2017)





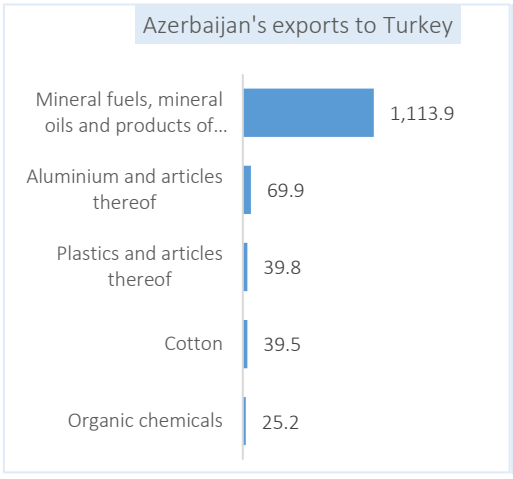
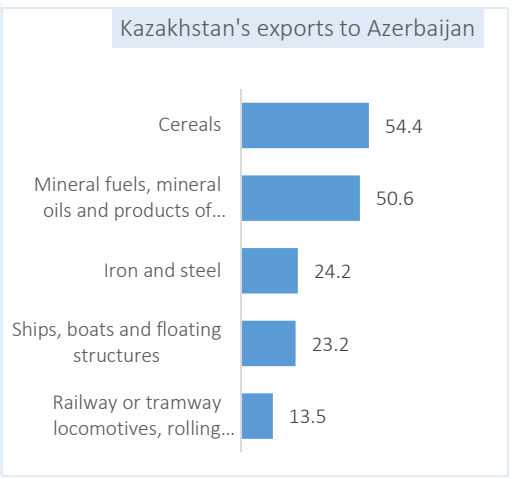
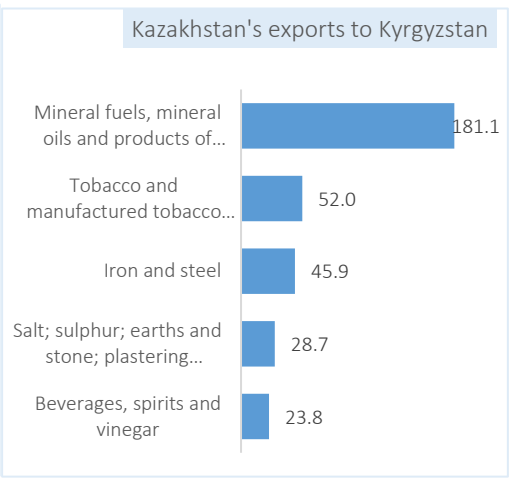


Figure 2.11b: Kazakhstan's Export to Other TC MCs - Top 5 Products (2018)

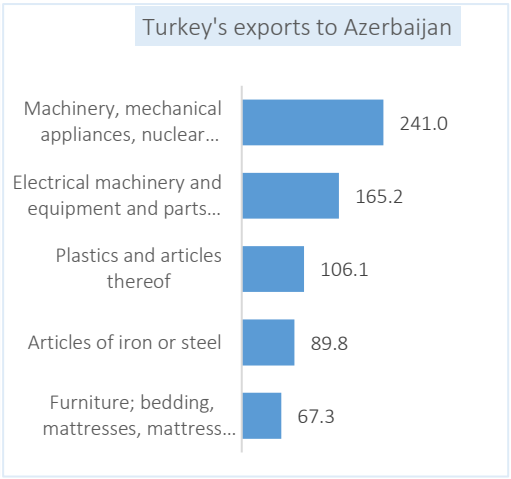




Source: TradeMap, International Trade Centre.

Figure 2.11c: Kyrgyzstan's Export to Other TC MCs - Top 5 Products (2018)

Figure 2.11d: Turkey's Export to Other TC MCs - Top 5 Products (2018)



Source: TradeMap, International Trade Centre.

Turkey's exports to other TC MCs are predominantly manufacturing products. In 2018, it exported to Azerbaijan mainly machinery (USD 241 million), and electrical machinery and equipment (USD 165 million), followed by plastics, articles of iron or steel, and furniture. The same two sectors also dominate its exports to Kazakhstan with USD 105 million and USD 61 million worth of exports, respectively. These are followed by articles of apparel and iron/steel. Exports to Kyrgyzstan from Turkey includes textile products, but also some precious stones/metals and machinery products (Figure 2.11d).

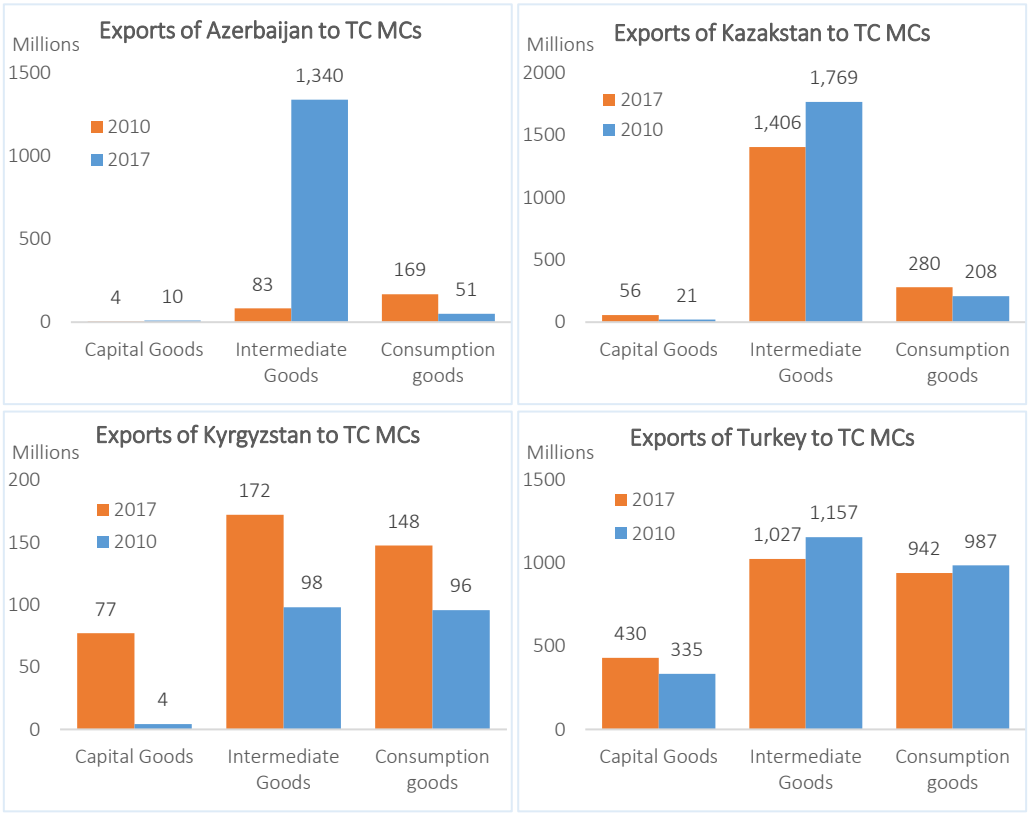
Globalisation, falling trade costs and technological progress have led to fragmentation of production processes and growth of global value chains. Firms started to obtain intermediate inputs from the most cost and time effective producers regardless of their geographical location. This interconnectedness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

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

Figure 2.12 shows the distribution of trade according to three broad types of goods explained above. Structure of products exported by Azerbaijan has substantially changed over time. While 66% of its exports were consumption goods in 2010, now more than 95% of its exports are intermediate goods. Such dramatic change has not been observed in other countries. Kazakhstan were also exporting mainly intermediate goods, but its share has increased from 81% in 2010 to 89% in 2017. Intermediate goods had also the largest share in exports from Kyrgyzstan, but capital goods and consumption goods had also notable share in total exports of the country in 2010. In 2017, the share and volume of capital goods has substantially declined and volume of consumption goods almost equalized to intermediate goods, despite the fall in total volumes. Turkey remained exporter of all types of goods, but the volume and share of capital goods has slightly declined. Turkey's main exports to TC MCs consisted mainly intermediate and consumption goods.

High share of intermediate goods in total exports of TC MCs imply that there is considerable interconnectedness in supply chain across the countries. It could be an indication of greater potential of economic integration among the TC MCs if existing barriers to further development of trade and investment are well identified and removed.

Figure 2.12: Structure of Trade among TC MCs (2017)



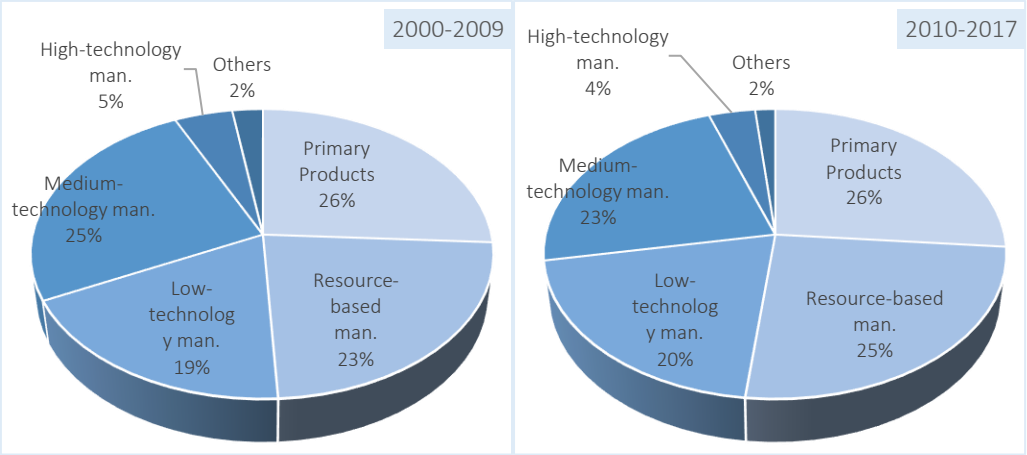
Source: SESRIC staff calculations based on UN Comtrade Database

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

Resource based products tend to be simple and labour-intensive (e.g. simple food or leather processing), but there are sectors using capital, scale and skill-intensive technologies (e.g. petroleum refining or modern processed foods). The share of these products in intra-TC trade increased from 23% to 25% during the period under consideration. Evidently, more than half of the intra-TC trade represent zero or close-to-zero technological intensive products.

Low technology products tend to have stable, well-diffused technologies. They are undifferentiated products where the technologies are mainly embodied in the capital equipment.

Figure 2.13: Structure of Trade among TC MCs by Technological Intensity



Source: SESRIC staff calculations based on UN Comtrade Database.

These include textile fabrics, leather products, footwear, furniture, toys and plastic products. Around 20% of all intra-TC trade represent low technological intensity.

Medium technology intensive products tend to have complex technologies, with moderately high levels of R&D, advanced skill needs and lengthy learning periods. Automotive products, processing industries (such as synthetic fibres, chemicals and paints, and fertilisers) and engineering industries (such as engines, motors, industrial machinery and watches) are the common examples of medium-technology products. Their share in total intra-TC trade declined from 25% during 2000-2009 to 23% during 2010-2017. Similarly, the share of high-technology products including electronics and electrical products, pharmaceuticals, aerospace and optical instruments declined from 5% to 4% during the same period.

Evidently, technological intensity of the products traded among TC MCs has declined over the two periods compared. One explanation would be that TC MCs are already not quite capable of producing high technology products in order to trade with each other. Other explanation would be that the member countries are not aware of possible complementarities in medium and high technology products to trade with each other. Whatever the reason, there is a need to increase cooperation and partnership among the member countries to improve the capacities for production of medium and high technology products and facilitate the trade of these goods among the member countries.

Similar to the analysis on technological intensity of products, exported goods can also be classified according to their price levels. CEPII provide a systematic decomposition of world trade using a new database built on a harmonized version of trade unit values, which allows to classify the goods as low, medium and high price products. This allows us to judge on the quality of products exported among the member countries, assuming that prices are an indicator of the quality and sophistication of products.

Figure 2.14a: Trade with World by Price Range (2010-2017)

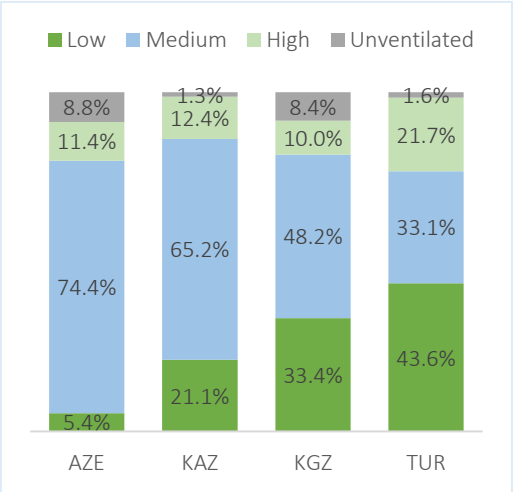
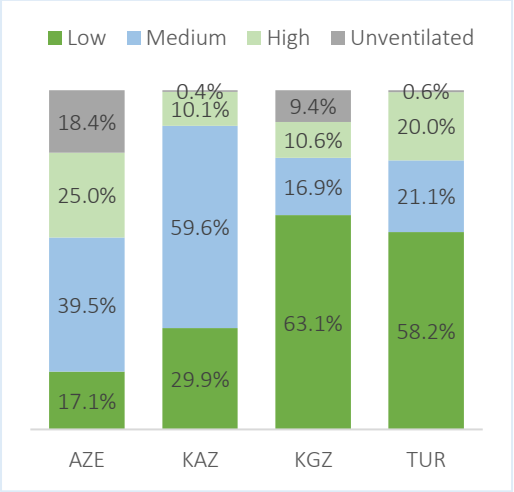


Figure 2.14b: Trade with TC MCs by Price Range (2010-2017)



Source: SESRIC staff calculations based on CEPII WTFC Database.

Figure 2.14a shows the trade patterns of TC MCs with the rest of the world. Azerbaijan and Kazakhstan appear to export a good share of products at medium price range, but the share of products at high price range is around 11-12%. In the case of Kyrgyzstan, the share of products at low price range is as much as 33%, while medium price range products account for 48% of its total exports. Turkey exports the largest amount of low price range products with almost 44% share, but more than 21% of its exports represent high price products.

When we look at the structure of trade among the TC MCs, as depicted in Figure 2.14b, we observe great divergence compared to their trade with the rest of the world. Azerbaijan exports comparably a larger share of high price products and low price products, but much lower share of medium price products. In the case of Kazakhstan, low price products account for larger share of exports to TC MCs than its exports to the world. This is more pronounced in Kyrgyzstan, whose exports to TC MCs constitute mainly low price products. The same observation is also true in Turkey, where low price products account larger share of exports to TC MCs when compared to its exports to the world. As a result, it can be argued that intra-TC trade constitute relatively lower quality products compared to their exports to the world.

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

Figure 2.15a: Types of Trade with World (2010-2017 Average)

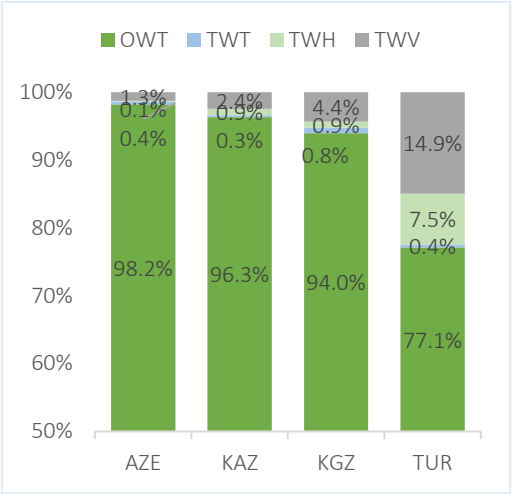
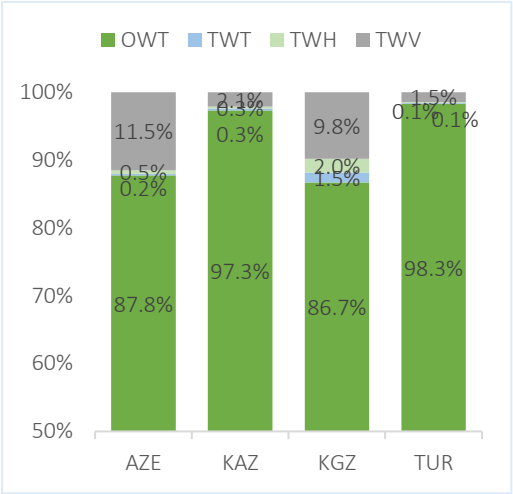


Figure 2.15b: Types of Trade with TC MCs (2010-2017 Average)



Source: SESRIC staff calculations based on CEPII WTFC Database.

Figure 2.15 shows the disaggregated data for inter-industry trade (or one-way trade – OWT), horizontal intra-industry trade, i.e. intra-industry trade in similar products (TWH), and vertical intra-industry trade, i.e. intra-industry trade in differentiated products. Two-way trade (TWT) represents the share of intra-industry trade where distinction cannot be made whether it is in similar products or differentiated products due to missing unit values.

Trade patterns of Azerbaijan, Kazakhstan and Kyrgyzstan with the world demonstrate a heavy concentration of inter-industry trade with a share of between 94%-98% (Figure 2.15a). This share is also significantly high in Turkey (77%), but intra-industry trade in similar products (7.5%) and intra-industry trade in differentiated products (14.9%) account almost one-quarter of its trade with the world.

Intra-TC trade patterns show some divergence from the trade patterns of the member countries with the world (Figure 2.15b). While Azerbaijan and Kyrgyzstan have a larger share of vertical intra-industry trade with TC MCs, Turkey trade mostly in inter-industry products. This result implies that bulk of the trade among TC MCs takes place inter-industry, which indicates that there are great complementarities in trade of goods across industries, but there is less integration in terms of production processes.

3 Trade Policies and Barriers to Trade

Trade policies refer to the policy framework, laws, regulations and international agreements that are used to affect international trade flows mainly through tariffs and non-tariff barriers. The main objective of trade policy is to maximise the nation's welfare through increased economic efficiency (Bartók and Miroudot, 2008). It also aims at improving market access for domestic firms, promoting productivity growth and facilitating the integration of the economy into global markets.

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

This chapter reviews the major trade policies adopted by the TC MCs, particularly in relation to the flow of goods among themselves. It analyses the tariff and non-tariff barriers to trade, evaluates the bilateral trade costs and custom procedures, and discusses some aspects of trade facilitation among the TC MCs.

3.1 Review of Trade Policies

Azerbaijan has had observer status at the World Trade Organization (WTO) since 1997 and began negotiations with WTO members on accession in 2004. Progress on accession stalled following the adoption of import substitution as a policy goal. In order to support domestic agriculture sector, government has prioritized import-substitution for food products, raising tariffs to keep many foreign products out of the market (ITA, 2019). Azerbaijan has free trade agreements (FTAs) with Russia, Ukraine, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Moldova and Belarus, which allow imports of goods from those countries free of customs duties.

Kazakhstan joined the WTO in 2015. Under its WTO commitments, Kazakhstan agreed to gradually lower 3,512 tariff rates to an average of 6.1% by 2020. The rates are already lowered for around 3,000 items (USTR, 2019). Kazakhstan introduced administrative measures to prevent the re-export of goods released at these lower tariff rates to Armenia, Belarus, Kyrgyzstan or Russia. Kazakhstan is a signatory of a Free Trade Agreement (FTA) with CIS countries (Azerbaijan, Armenia, Belarus, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan).

Kazakhstan also entered into a Customs Union with Russia and Belarus in 2010 and was a founding member of the Eurasian Economic Union (EAEU). The EAEU was established in 2014 between Kazakhstan, Belarus, Kyrgyz Republic, and Russia. Kazakhstan's trade policy has been

heavily influenced by EAEU regulations. The Eurasian Economic Commission (EEC) implements external trade policy for member states and coordinates economic integration among member states of the EAEU to make the region more attractive for foreign investment by expanding market size. The EAEU Customs Code governs customs rules for all member countries and most of Kazakhstan's import tariff levels, trade-in-transit rules, nontariff import measures, and customs policies are based on EAEU legal instruments.

The Kyrgyz Republic has been a member of WTO since 1998. In August 2015, the Kyrgyz Republic also joined the Eurasian Economic Union (EAEU). With its entry into the EAEU, the average import tariff rate increased from 5% to 9.4% (ITA, 2019). By opening up the markets, the member countries expose domestic producers to greater competition, but this puts pressure on governments to consider raising custom duties, which in turn contradicts with the spirit of greater economic integration. In 1994, CIS member states agreed to establish a free-trade zone. The agreement signed by the member states allows imports of goods produced within the CIS without any customs or value-added taxes in the Kyrgyz Republic, with exemption of some products, such as furniture, video, television and computer equipment. Kazakhstan and the Kyrgyz Republic have also signed a customs agreement together with Russia, Belarus and Tajikistan. The Kyrgyz Republic has bilateral investment treaties with 26 countries, including Azerbaijan, Kazakhstan and Turkey. The Kyrgyz Republic has also signed double-taxation treaties with 27 countries including Kazakhstan and Turkey.

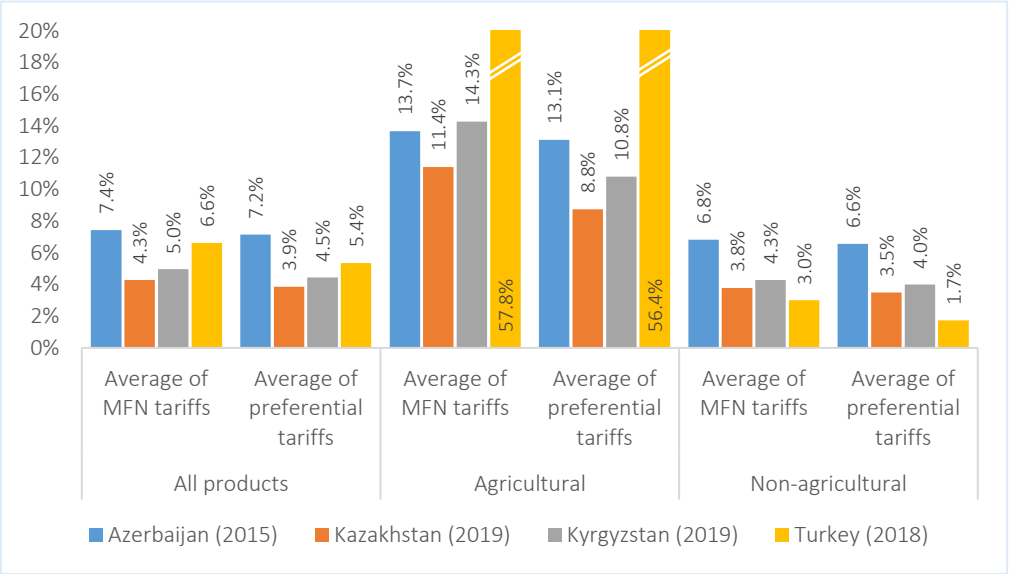
Turkey has been a member of WTO since March 1995 and a member of GATT since October 1951. Turkey has bound over half of its tariff lines under the WTO (USTR, 2019). In accordance with its customs union agreement with the European Union (EU), Turkey exempts from tariffs non-agricultural products imported from the EU and applies the EU common external tariff to third country non-agricultural imports. Turkey also exempts from tariffs non-agricultural products imported from other trading partners with which it has concluded free trade agreements. Turkey is member of the Euro-Mediterranean partnership (Euromed) and in process of concluding free trade agreements with all other Mediterranean partners with a view to creating a Euro-Mediterranean FTA. Turkey has more than 25 FTAs, but not with TC MCs.

3.2 Barriers to Trade

Countries commonly use trade policy measures, including tariffs and non-tariff barriers, to discourage the importation of foreign products and spur industrial growth and economic diversification aligned with national development and industrialization policies. Support measures introduced for particular industrial sectors, combined with tariff and/or other trade measures, aim to protect these sectors from foreign competition on the domestic market and boost their export performance at the same time. Such trade policies affect economic activity and well-being not only in the country enacting these policies but in their trade partner countries as well.

The most common barrier to trade has been a tariff, or a tax on imported goods. Tariffs raise the price of foreign goods relative to domestic goods. Global efforts towards facilitating trade flows

Figure 3.1: Average Tariff Rates Applied by TC MCs



Source: International Trade Centre MacMap Database.

across borders over the last several decades reduced the average tariff rates to historically their lowest levels. Nonetheless, it remains a usual practice by governments to apply certain level of tariffs to protect particular sectors or industries.

Figure 3.1 shows the average tariff rates applied by TC MCs for the latest year the data available. With an average rate of 7.4%, Azerbaijan applies the highest Most Favoured Nation (MFN) tariff rates within the TC region. Average of preferential rates was 7.2% in 2015. Average MFN rate for agricultural products was 13.7%, while it was 6.8% for non-agricultural products.

In 2019, Kazakhstan's MFN applied tariff averaged 4.3% and preferential rate was recorded at 3.9%. Kazakhstan applies a zero percent rate on approximately 1,900 tariff lines, including livestock, fish products, chemical and pharmaceutical products, cotton, machinery and equipment, medical vehicles, and some types of airplanes (USTR, 2019). Kazakhstan's average MFN applied tariff rate is 11.4% for agricultural products and 3.8% for non-agricultural products. The average preferential rates are 8.8% for agricultural products and 3.5% for non-agricultural products. Thereby, the lowest tariffs for agricultural products were applied by Kazakhstan within the TC region.

Average tariff applied by Kyrgyzstan were also relatively low. Average MFN applied tariff was 5.0%, while preferential rate was 4.5% in 2019. Rates applied for agricultural products were higher than non-agricultural products, as in the case of other countries. It was recorded at 14.3% for agricultural products and 4.3% for non-agricultural products.

Turkey's applied MFN and preferential tariff rates average 6.6% and 5.4%, respectively. The largest difference between MFN and preferential rates was recorded in Turkey. However, Turkey continues to maintain high tariff rates on many imported food and agricultural products. In 2018,

Turkey applied 57.8% MFN tariff rates and 56.4% preferential tariff rates. Tariffs for non-agricultural products were lowest among the TC MCs, which was recorded at 3.0% (MFN) and 1.7% (preferential). Tariffs on fresh fruits range from 20% to 162%, while the range for poultry tariffs is between 30% and 75%. Turkey recently has taken advantage of substantial differences between its applied and WTO bound tariff rates to increase tariffs significantly across multiple sectors. Since mid-2014, Turkey has increased tariffs by an average of 26% on products classified

Table 3.1: Azerbaijan's Average Applied Tariffs by HS Rev. 2017 Section (2018)

Sect. Code	Section Description	Average Tariff Rate
4	Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes	14.7%
8	Raw hides and skins, leather, furskins and articles thereof; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	14.4%
14	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	14.4%
20	Miscellaneous manufactured articles	14.0%
12	Footwear, headgear, umbrellas, sun umbrellas, walking-sticks, seat-sticks, whips, riding-crops and parts thereof; prepared feathers and articles made therewith; artificial flowers; articles of human hair	13.8%
13	Articles of stone, plaster, cement, asbestos, mica or similar materials; ceramic products; glass and glassware	13.7%
1	Live animals; animal products	13.4%
11	Textiles and textile articles	13.3%
10	Pulp of wood or of other fibrous cellulosic material; recovered (waste and scrap) paper or paperboard; paper and paperboard and articles thereof	10.2%
9	Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork	9.8%

Source: ITC Trade Map.

Table 3.2: Kazakhstan's Average Applied Tariffs by HS Rev. 2017 Section (2018)

Sect. Code	Section Description	Average Tariff Rate
19	Arms and ammunition; parts and accessories thereof	13.9%
4	Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes	11.7%
1	Live animals; animal products	10.9%
8	Raw hides and skins, leather, furskins and articles thereof; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	9.4%
17	Vehicles, aircraft, vessels and associated transport equipment	9.2%
13	Articles of stone, plaster, cement, asbestos, mica or similar materials; ceramic products; glass and glassware	9.1%
20	Miscellaneous manufactured articles	8.3%
9	Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork	7.8%
11	Textiles and textile articles	7.5%
14	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	7.4%

Source: ITC Trade Map.

in 50 Harmonized System (HS) chapters, affecting a wide range of sectors, including furniture, medical equipment, tools, iron, steel, footwear, carpets, and textiles (USTR, 2019).

Tables 3.1 - 3.4 show the average applied tariffs by TC MCs in 2018. The tables list the top ten sectors where countries apply the highest rates on average to foreign producers. The highest rates applied by Azerbaijan range approximately between 10% and 15%, where prepared foodstuffs, beverages and tobacco products are imposed the highest protection with a rate of 14.7% (Table 3.1). It is followed by leather and articles of similar products and travel goods (14.4%) and pearls, precious metals and jewellery (14.4%).

Table 3.3: Kyrgyzstan's Average Applied Tariffs by HS Rev. 2017 Section (2018)

Sect. Code	Section Description	Average Tariff Rate
1	Live animals; animal products	15.8%
19	Arms and ammunition; parts and accessories thereof	13.9%
11	Textiles and textile articles	13.9%
4	Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes	12.9%
8	Raw hides and skins, leather, furskins and articles thereof; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	9.5%
13	Articles of stone, plaster, cement, asbestos, mica or similar materials; ceramic products; glass and glassware	9.3%
20	Miscellaneous manufactured articles	8.6%
17	Vehicles, aircraft, vessels and associated transport equipment	8.4%
9	Wood and articles of wood; wood charcoal; cork and articles of cork; manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork	8.1%
14	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal, and articles thereof; imitation jewellery; coin	7.4%

Source: ITC Trade Map.

Table 3.4: Turkey's Average Applied Tariffs by HS Rev. 2017 Section (2018)

Sect. Code	Section Description	Average Tariff Rate
1	Live animals; animal products	106.4%
2	Vegetable products	38.6%
4	Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes	37.2%
3	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes	24.9%
12	Footwear, headgear, umbrellas, sun umbrellas, walking-sticks, seat-sticks, whips, riding-crops and parts thereof; prepared feathers and articles made therewith; artificial flowers; articles of human hair	5.8%
11	Textiles and textile articles	5.4%
17	Vehicles, aircraft, vessels and associated transport equipment	3.8%
15	Base metals and articles of base metal	2.8%
7	Plastics and articles thereof; rubber and articles thereof	2.5%
8	Raw hides and skins, leather, furskins and articles thereof; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	2.0%

Source: ITC Trade Map.

Highest average tariffs applied by Kazakhstan is 13.9% for arms, ammunition and their parts. Prepared foodstuffs, beverages and tobacco products (11.7%), and live animals and animal products (10.9%) are also among the sectors that have highest protection for foreign producers (Table 3.2). A similar picture is observed in the case of Kyrgyzstan. Live animals and animal products, and arms, ammunition and their parts have the highest taxes for importers with tariff rates of 15.8% and 13.9%, respectively. The third highest rate is applied to textiles and textile articles with a rate of 13.9% (Table 3.3).

The types of products where highest taxes are applied for importers resembles in these three countries. Eight out of ten top products with highest tariff rates are the same in Azerbaijan, Kazakhstan and Kyrgyzstan. These are the products with a section code of 1 (Live animals; animal products), 4 (Prepared foodstuffs; beverages …), 8 (Raw hides and skins, leather …), 9 (Wood and articles of wood), 11 (textiles and textile articles), 13 (Articles of stone, plaster …), 14 (Natural or cultured pearls …) and 20 (Miscellaneous manufactured articles). Most of the affected products are primary products with no or low technological intensity. This indicates that these countries primarily aim to protect the low-skill intensive jobs against foreign competition for them to protect their livelihoods and earnings.

In Turkey, some products are protected with considerably high tariff rates. It puts 106.4% tariffs on live animals and animal products, 38.6% on vegetable products and 37.2% on prepared foodstuffs, beverages and tobacco products. Oil and fat products also enjoy a rate of 24.9% protectionism from global producers. Average tariffs applied to other products are relatively small and it drops as low as 2% for the tenth most protected sector. Evidently, while Turkey puts above-the-average tariff rates for certain agricultural commodities, it follows fairly free trade for other commodities. Moreover, four products are also among the top 10 products list of other three countries, namely 1 (Live animals; animal products), 4 (Prepared foodstuffs; beverages …), 8 (Raw hides and skins, leather …) and 11 (textiles and textile articles).

Bilateral Tariffs

Table 3.5 shows the list of tariff regimes applied by TC MCs. As part of Eurasian Customs Union, Kazakhstan and Kyrgyzstan enjoys zero tariff rates in their trade with each other. Azerbaijan, Kazakhstan and Kyrgyzstan have preferential tariffs within the framework of CIS agreements. Turkey applies non-MFN tariffs to Azerbaijan, MFN tariffs to Kazakhstan and preferential tariffs to Kyrgyzstan within the framework of Generalized System of Preferences (GSP). It is evident that although trade restrictions among Azerbaijan, Kazakhstan and Kyrgyzstan are almost entirely lifted, Turkey's trade relations with these countries linger with certain restrictions.

When we look at the products with highest tariff rates among the TC MCs, we observe that bilateral tariffs between Azerbaijan, Kazakhstan and Kyrgyzstan are effectively zero in almost all products. However, there are tariffs at varying levels in their trade relations with Turkey. In most cases, import taxes applied to products are the same for all member countries. Meat, dairy products and sugars are the products that Turkey imposes highest restrictions for imports from other TC MCs. For meat products, this rate goes up to 166.5% (Table 3.6).

Table 3.5: Tariff Regimes of TC MCs

Country	Tariff Regime	Benefiting TC MCs	Other Tariff Regimes
Azerbaijan (2015)	Preferential tariff for CIS countries	Kazakhstan and Kyrgyzstan	
	General Tariff	Turkey	
Kazakhstan (2019)	Eurasian Customs Union	Kyrgyzstan	Preferential tariff for LDCs; Serbia; Vietnam
	Preferential tariff for CIS countries	Azerbaijan	
	Preferential tariff for GSP countries	Turkey	
Kyrgyzstan (2019)	Eurasian Customs Union	Kazakhstan	Preferential tariff for GSP countries; LDCs; Vietnam
	Preferential tariff for CIS countries	Azerbaijan	
	Preferential tariff for GSP countries	Turkey	
Turkey (2018)	Non-MFN Tariff	Azerbaijan	Preferential tariff for Albania; Bosnia and Herzegovina; Chile; D-8 countries; EFTA countries; Egypt; European Union countries; Faroe Islands; Georgia; GSP countries; Iran; Israel; Jordan; Kosovo; LDCs; Macedonia; Malaysia; Mauritius; Montenegro; Morocco; Palestine; Serbia; Singapore; Republic of Korea; Moldova; Tunisia.
	MFN Applied	Kazakhstan	
	Preferential tariff for GSP countries	Kyrgyzstan	

Source: International Trade Centre MacMap Database. Note: GSP - The Generalized System of Preferences.

Table 3.6: Average Tariff Rates Applied by Turkey for Imported Products from Other TC MCs

	TUR - AZE	TUR-KAZ	TUR-KGZ
Meat and edible meat offal	166.5	166.5	166.5
Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included	135.7	135.7	135.6
Sugars and sugar confectionery	108.2	108.2	107.4
Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	95.8	95.8	95.8
Edible fruit and nuts; peel of citrus fruits or melons	62.6	62.5	62.5
Preparations of vegetables, fruit, nuts or other parts of plants	56.0	56.0	56.0
Live animals	54.3	54.3	54.3
Products of the milling industry; malt; starches; inulin; wheat gluten	43.1	43.1	43.1
Coffee, tea, mate and spices	37.6	37.6	37.6
Tobacco and manufactured tobacco substitutes	37.5	37.5	28.1
Source: International Trade Centre MacMap Database.			

With regards to the tariffs applied by Azerbaijan, Kazakhstan and Kyrgyzstan for Turkish products, we observe more moderate numbers. As shown in Table 3.7, Azerbaijan applies the highest tariffs

Table 3.7: Average Tariff Rates Applied by Other TC MCs for Turkish Export Products					
AZE-TUR		KAZ-TUR		KGZ-TUR	
Carpets and other textile floor coverings	37.9	Beverages, spirits and vinegar	27.9	Meat and edible meat offal	34.9
Beverages, spirits and vinegar	27.0	Meat and edible meat offal	22.5	Beverages, spirits and vinegar	29.3
Articles of apparel and clothing accessories, knitted or crocheted	15.0	Sugars and sugar confectionery	21.7	Sugars and sugar confectionery	27.8
Articles of apparel and clothing accessories, not knitted or crocheted	15.0	Umbrellas, sun umbrellas, walking-sticks, seat-sticks, whips, riding-crops and parts thereof	15.0	Articles of apparel and clothing accessories, knitted or crocheted	19.5
Other made-up textile articles; sets; worn clothing and worn textile articles; rags	15.0	Arms and ammunition; parts and accessories thereof	14.7	Articles of apparel and clothing accessories, not knitted or crocheted	17.7
Knitted or crocheted fabrics	15.0	Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	12.0	Umbrellas, sun umbrellas, walking-sticks, seat-sticks, whips, riding-crops and parts thereof	15.0
Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery	15.0	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included	10.7	Arms and ammunition; parts and accessories thereof	14.7
Albuminoidal substances; modified starches; glues; enzymes	15.0	Preparations of cereals, flour, starch or milk; pastry cooks' products	10.5	Other made-up textile articles; sets; worn clothing and worn textile articles; rags	13.6
Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof	15.0	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	10.3	Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of animal gut (other than silkworm gut)	12.7
Cocoa and cocoa preparations	15.0	Prepared feathers and down and articles made of feathers or of down; artificial flowers; articles of human hair	10.3	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	11.5
Source: International Trade Centre MacMap Database.					

on carpets and other textile floor coverings (37.9%) and beverages (27%). The other products in the table enjoys 15% protection from Turkish exporters. Beverages is the top product category where Kazakhstan puts the highest restriction with a tariff rate of 27.9%. Meat (22.5%) and sugar (21.7%) are other products where Turkish exporters face the most restrictions in Kazakh market. Meat, beverages and sugars are also the top products with highest tariff rates for Turkish exports to enter into the Kyrgyz market, with tariff rates of 34.9%, 29.3% and 27.8%, respectively.

Non-Tariff Measures

Regional integration efforts around the world reduce the barriers for trade across the borders and in many cases tariff measures do not constitute a major barrier for traders any longer. The

ability to benefit from market access depends increasingly on compliance with trade regulatory measures, or Non-Tariff Measures (NTMs), such as sanitary and quality requirements for goods. Such measures are becoming a growing challenge for exporters, importers and policy makers. Thereby, they are increasingly shaping trade, influencing who trades what and how much.

NTMs are defined by UNCTAD as "policy measures, other than customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both" (UNCTAD, 2009). The International Classification of NTMs distinguishes at the most detailed level 177 types of measures (UNCTAD, 2013). Many NTMs aim primarily at protecting public health or the environment (Sanitary and Phytosanitary [SPS] measures and Technical Barriers to Trade [TBT]), they also substantially affect trade through information, compliance and procedural costs. Due to their important primary objectives, some types of measures such as protection of health or the environment cannot simply be eliminated. Other trade and trade related policies include price and quantity measures, licensing requirements, subsidies, competition related polices, export measures, among others. Some of these non-technical measures can be used by some countries to discourage foreign producers to enter into domestic markets.

The Global Database of UNCTAD on Non-Tariff Measures, the TRAINS database, compiles data on requirements enacted in official regulations. Measures are divided into two broad categories: import measures and export measures. Import measures are further subdivided into technical measures and non-technical measures. The first group is comprised of three chapters: SPS, TBT, and pre-shipment inspection and other formalities. Non-technical measures are subdivided into twelve chapters, which includes contingent trade-protective measures, price-control measures, measures affecting competition and rules of origin (see UNCTAD 2018 for detailed descriptions).

The database cover statistics for Kazakhstan and Turkey within the TC region. It contains three indexes as proxies for NTMs occurrence; frequency index, coverage ratio and prevalence score. The frequency index simply captures the percentage of products that are subject to one or more NTMs. The coverage ratio captures the percentage of imports that is subject to one or more NTMs. The prevalence score captures the average number of NTMs which apply to a product.

The frequency index and coverage ratio for Kazakhstan is very high, indicating that more than 95% of products are subject to one or more NTMs (Figure 3.2, upper). Moreover, average number of NTMs applied for a product is also relatively high. On average, 4.6 types of NTMs are applied for a product imported to Kazakhstan. SPS measures have low frequency (4%) but high prevalence scores (8.9). TBT measures and export measures have high coverage ratio (96% and 75%, respectively).

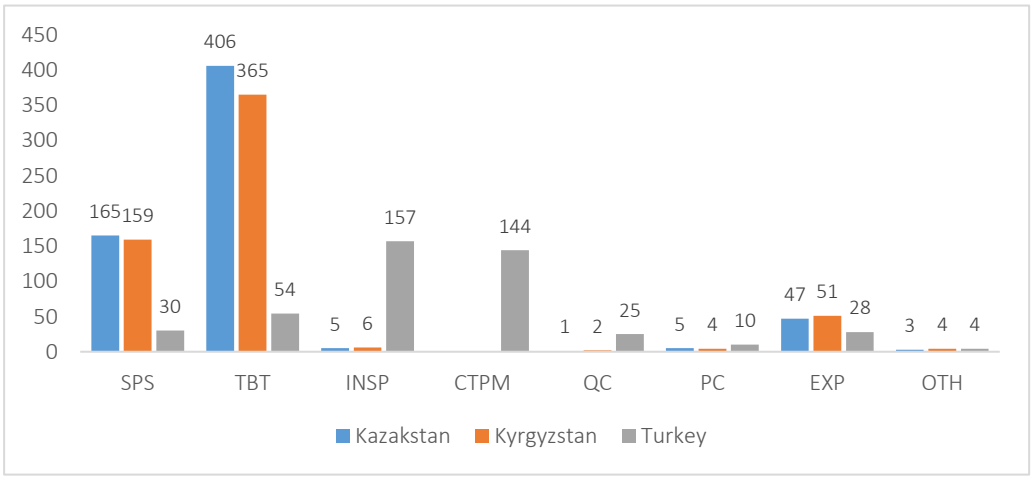
In the case of Turkey, frequency index and coverage ratio is significantly lower than Kazakhstan. 57% of products and 61% of imports are subject to NTMs. On average, 1.6 measures are applied for each product (Figure 3.2, lower). Highest prevalence score is observed for TBT measures in Turkey with a score of 1.8. It has also the highest frequency index (19%) and coverage ratio (49%) compared to other measures.

Figure 3.3 shows the total number of NTMs applied by Kazakhstan, Kyrgyzstan and Turkey. In both Kazakhstan and Kyrgyzstan, TBT measures are the most frequently applied measures with a total of 406 and 365, respectively. SPS measures are the second most frequently applied in these countries. Turkey demonstrates a different picture. Pre-shipment inspection (157) and contingent trade protective measures (144) are the two most frequently applied measures by Turkey. Export-related measures are also applied by these countries at a number ranging between 28 and 51.

A database which cover statistics for all TC MCs is the WEF Global Competitiveness Index. It specifically asks "to what extent do non-tariff barriers (e.g. health and product standards, technical and labelling requirements, etc.) limit the ability of imported goods to compete in the domestic market?" and score the responses from 1 to 7, with higher values indicating strong limitation by NTMs. Figure 3.4 shows that Azerbaijan puts the highest limitations through non-tariff barriers with a score of 4.6. It is followed by Kazakhstan (4.5) and Turkey (4.4). The lowest restrictions are found to be in Kyrgyzstan (4.1). While Azerbaijan occupies the 46th rank in the world in terms of prevalence of non-tariff barriers, Kyrgyzstan ranks in the 103rd place.

Analyses on non-tariff barriers shows that there are great impediments against free trade flows due to non-tariff measures applied by the TC MCs. Due to data limitations, it was not possible to review the bilateral NTMs, but available data reveals that Sanitary and Phytosanitary (SPS) measures and Technical Barriers to Trade (TBT) constitute a major obstacle for importers to TC MCs. There measures are probably necessary for various health and environment reasons, but their applications should not be made in a way to discourage the traders in the member countries to expand their trade relations with their counterparts.

Figure 3.3: Non-Tariff Measures Applied by Kazakstan and Turkey



Source: UNCTAD TRAINS Database. Note: Sanitary and Phytosanitary [SPS], Technical Barriers to Trade [TBT], Pre-shipment inspection [INSP], Contingent trade protective measures [CTPM], Quantity control measures [QC], Price control measures [PC], Export-related measures [EXP], Other measures [OTH]

3.3 Trade Costs and Customs Procedures

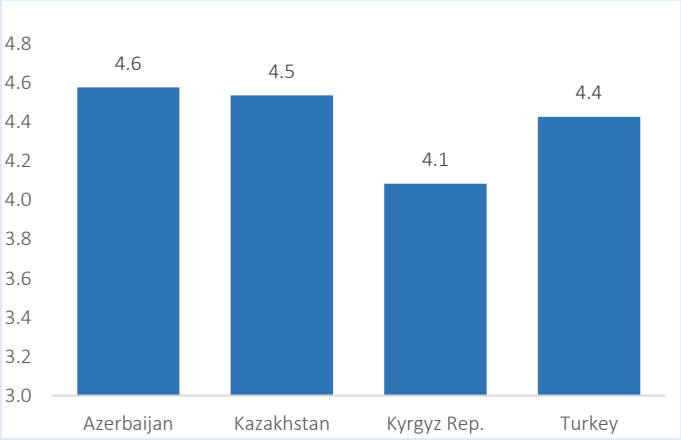
Since the initiation of the General Agreement on Trade and Tariffs in 1947, a dramatic fall in tariffs has been observed in the world trading system. Particularly in manufacturing goods, significant reductions were observed in tariff rates. Substantial improvements in transport and logistics over the years have also contributed to the fall in trade costs around the world. However, international trade remained more costly than domestic trade. This is not only due to costs of transporting goods to far distances, but also at-the-border and behind-the-border costs that can be reduced by appropriate policies. This fact accordingly shifted the attention from reducing policy barriers to promoting trade facilitation.

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

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

Figure 3.5 shows the trend in bilateral trade costs among the TC MCs. It is difficult to observe declining trend in bilateral trade costs. In most cases, the costs remain stable over the years, despite some fluctuations. The largest trade costs are observed between Azerbaijan and Kyrgyz Republic and it is almost constantly rising since 2012. In 2016, bilateral trade costs between two countries are estimated at 220% ad valorem, which indicates that an additional cost of 2.2 times of original value of goods are incurred in their shipment from producers to local customers.

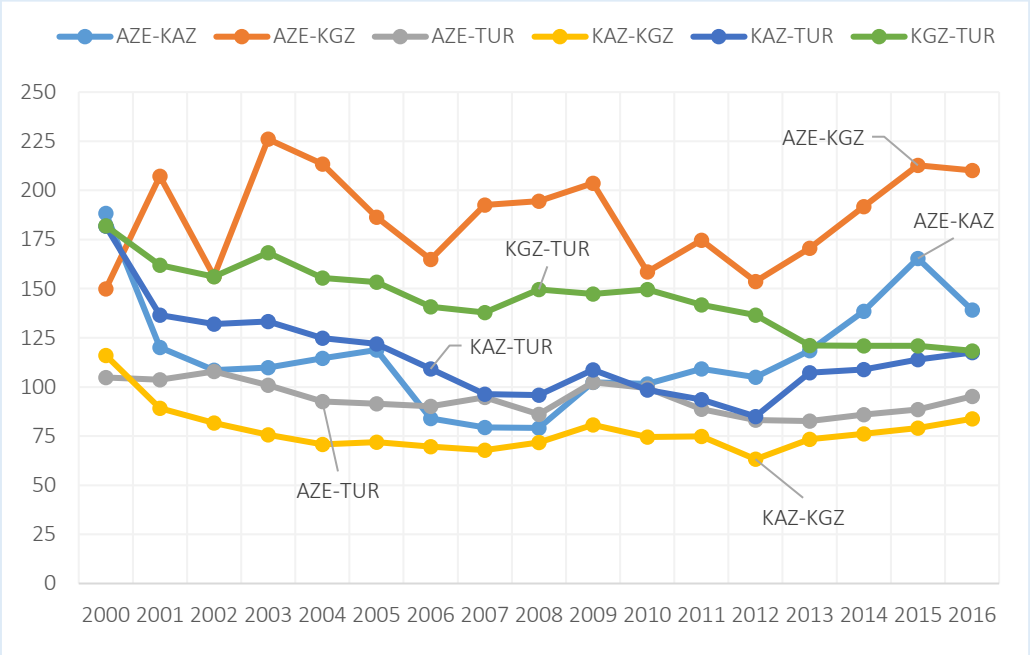
Figure 3.4: Prevalence of Non-Tariff Barriers



Source: WEF Global Competitiveness Index 2018-2019.

Trade costs between Azerbaijan and Kazakhstan has more than doubled between 2008 and 2015 by increasing from 79% to 165%. In 2016, a fall in trade costs is observed to reach 139%.

Figure 3.5: Trade Costs among TC MCs (2000-2016)



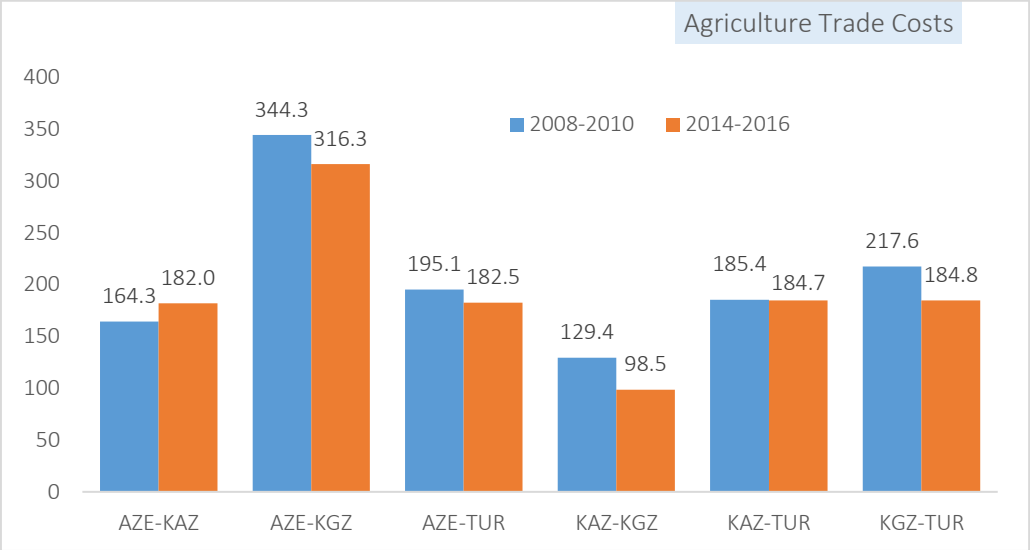
Source: SESRIC staff calculations based on ESCAP-WB Trade Costs Database.

However, it remains the second most costly trade relations within the TC region. Azerbaijan's trade costs with Turkey is comparably low. It generally fluctuates between 80%-100% and as of 2016 it stands at 95%. The lowest trade costs are observed between Kazakhstan and Kyrgyz Republic. Geographic proximity plays a great role in low trade costs. As of 2016, total trade costs between the two countries are estimated at 84% ad valorem. Trade costs between Turkey and Kazakhstan as well as Turkey and Kyrgyz Republic stand at 118% in 2016. These countries also represent the largest fall in trade costs since 2000.

Due to higher protectionism and perishable nature of products in agricultural sector, trade costs for agricultural products are higher than manufactured goods. Figures 3.6 and 3.7 compares the agricultural and manufacturing sector trade costs across the TC region for the periods 2008-2010 and 2014-2016. Except the trade costs between Azerbaijan and Kazakhstan, trade costs in all other bilateral relations have declined during the two periods under consideration. The highest trade costs are observed between Azerbaijan and Kyrgyz Republic, which was estimated to be 316%. The trade costs between Azerbaijan-Kazakhstan, Azerbaijan-Turkey, Kazakhstan-Turkey, and Kyrgyz Republic-Turkey are almost equal, which are found to be around 182%-184%. The lowest trade costs in agriculture was recorded between Kazakhstan and Kyrgyz Republic, which was estimated to be 99%.

With regards to trade costs in manufacturing goods, except two cases, bilateral trade costs have increased over the period under consideration. The largest increase was observed in the case of Azerbaijan and Kazakhstan, which increased from 90% to 143%. Trade costs between Azerbaijan and Kyrgyz Republic also increased substantially to reach 188% from 152%, which is the highest

Figure 3.6: Trade Costs among TC MCs (2000-2016)

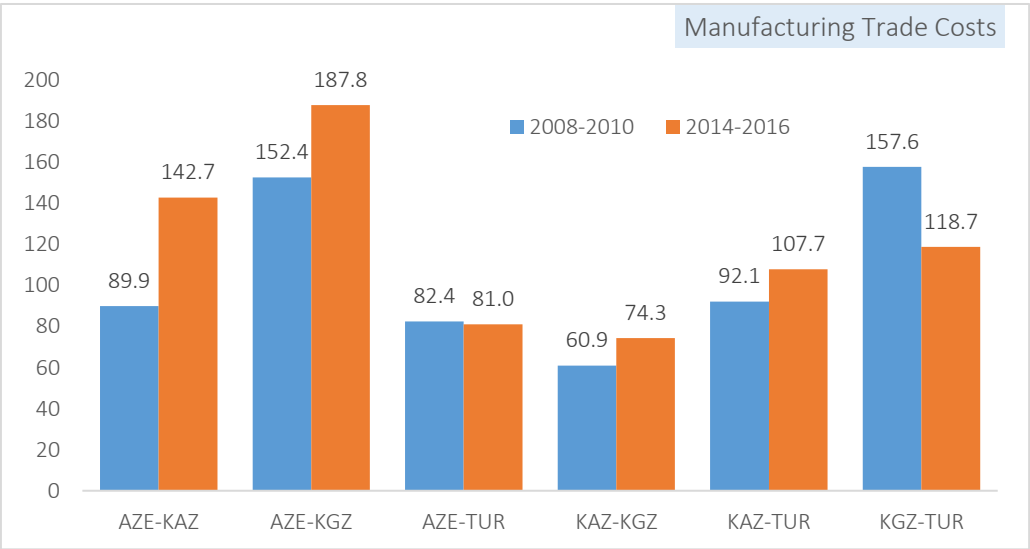


Source: SESRIC staff calculations based on ESCAP-WB Trade Costs Database.

rate of bilateral trade costs among TC MCs. Despite around 13% increase, trade costs between Kazakhstan and Kyrgyz Republic remains the lowest within the region with a rate of 74%. The largest fall in trade costs was observed between Kyrgyz Republic and Turkey. The costs have fallen from 158% to 119% for manufacturing trade between two countries.

Overall, it is promising to observe a fall in trade costs in agricultural products, but it is also quite worrisome to see rising costs of trade in manufacturing goods. Given the fact that a significant share of trade between TC MCs are composed of primary and agricultural products, the fall in

Figure 3.7: Trade Costs among TC MCs (2000-2016)



Source: SESRIC staff calculations based on ESCAP-WB Trade Costs Database.

trade costs are expected to ease trade flows even further. However, rising trade costs in manufacturing goods constitute a setback for further improvement of trade relations in these items. Therefore, measures should be taken to reduce trade costs in manufacturing goods, particularly between Azerbaijan - Kazakhstan and Azerbaijan - Kyrgyz Republic.

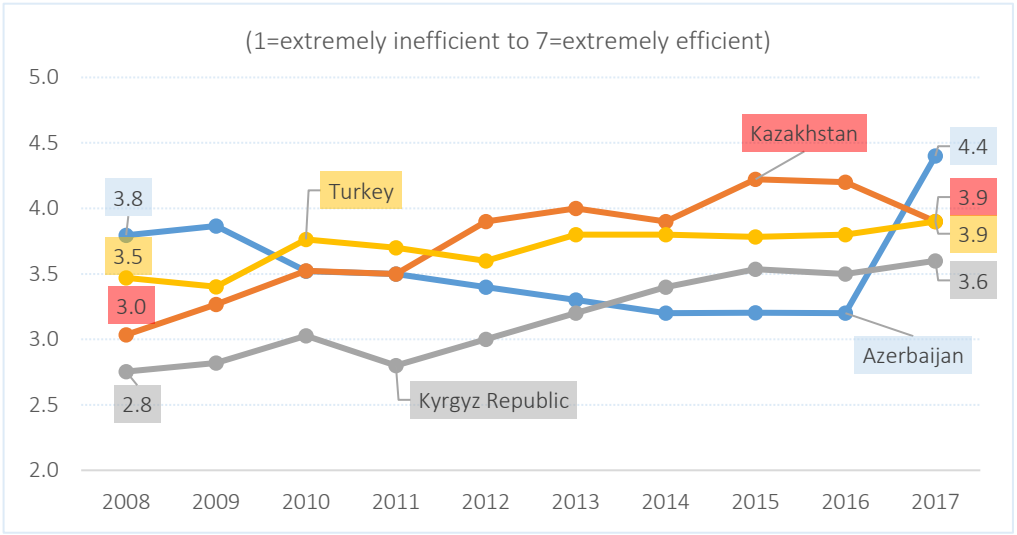
Custom Procedures

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

Figure 3.8 shows the evaluation of custom procedures in TC MCs. There has been some progress made in improving the efficiency of custom procedures over the last decade (2008-2017). The custom procedures in Azerbaijan have been deteriorating up until 2016, but significant improvement is recorded in 2017, which made it the top country in terms of custom procedures. Kazakhstan and Turkey have same scores for the burdensome of custom procedures, while Kyrgyz Republic attained a score of 3.6 out of 7 for the efficiency of its customs.

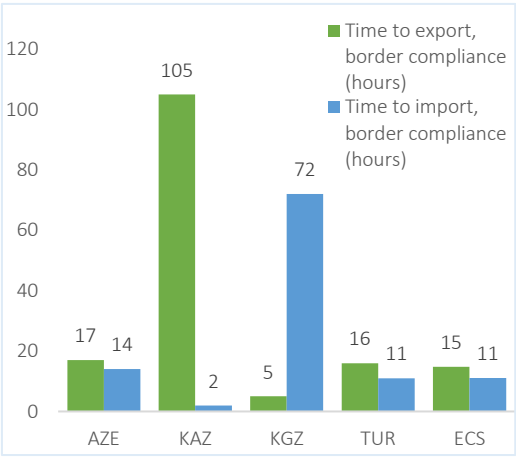
In order to have a better picture on the custom procedures in TC MCs, Figures 3.9-3.12 depicts the time and costs for border and documentary compliance. Figures also include average values for the countries in Europe and Central Asia (ECS) for comparison purposes. There are very diverging practices at the border crossings. It takes on average 105 hour in Kazakhstan to complete border compliances when exporting products from the country, but it takes only 2 hours for import (Figure 3.9). There is an opposite case in Kyrgyzstan. It takes 5 hours to complete

Figure 3.8: Burden of customs procedure, WEF (1=extremely inefficient to 7=extremely efficient)



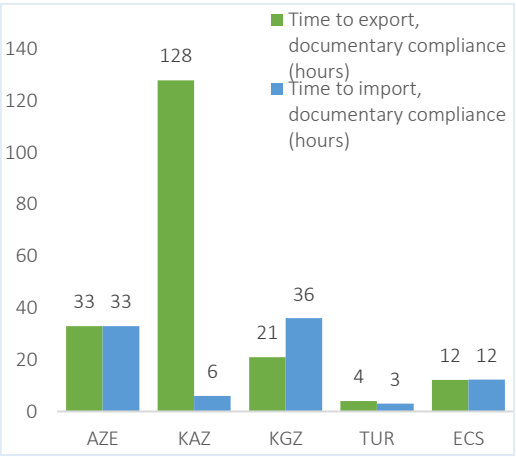
Source: WB WDI Database.

Figure 3.9: Time Required for Border Complience



Source: WB WDI Database. ECS: Europe and Central Asio

Figure 3.10: Time Required for Documentary Complience



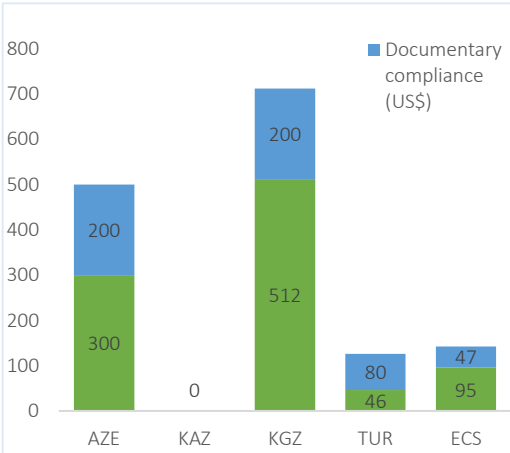
Source: WB WDI Database. ECS: Europe and Central Asio

border compliances for export, but it takes 72 hours for import. This implies that an exporter from Kazakhstan to Kyrgyzstan would require on average 177 hours to complete border compliances. Border compliances in Azerbaijan and Turkey is close the average of ECS.

A similar picture is observed in time required to complete documentary compliance. It takes 128 hours in Kazakhstan to complete documentary compliance for exporters, but only 6 hours for importers (Figure 3.10). In Azerbaijan, both exporters and importers require on average 33 hours to complete documentary compliance. Turkey has the lowest time required for documentary compliance, which is also below the average of European and Central Asian Countries.

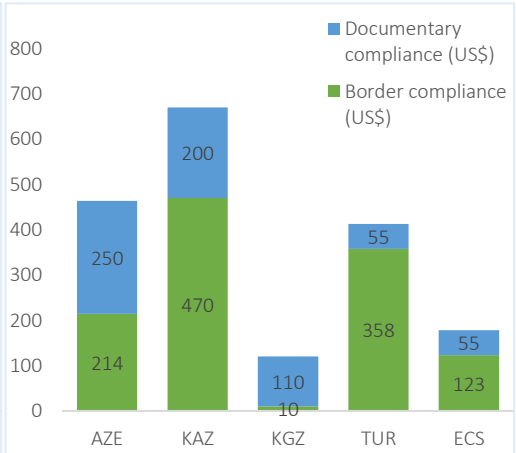
When we turn to the costs to export and import, we observe that the highest costs are incurred in Kyrgyzstan and Azerbaijan when exporting (Figure 3.11) and Kazakhstan and Azerbaijan when

Figure 3.11: Costs to Export



Source: WB WDI Database.

Figure 3.12: Costs to Import



Source: WB WDI Database.

importing (Figure 3.12). No cost is recorded for exporters from Kazakhstan, which should be a great facilitation for exporters. However, this opportunity is reversed due to long time required to complete border and documentary compliances. Kyrgyzstan appears to charge the highest amount for exporters, but it also charges the lowest amount for importers. Noting the fact that it has an expedited process for exporters in terms of time required to complete border and documentary compliance and rather delayed process for importers, the advantages provided to importers seem to be outweigh by the delays in completing compliances. Turkey charges the lowest amount to exporters after Kazakhstan, and lowest amount to importers after Kyrgyzstan.

3.4 Trade Facilitation

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

Over the last decade, it has gained prominence in the international political agenda, which has culminated in the conclusion of an agreement at global level. Trade Facilitation Agreement (TFA) of WTO entered into force in February 2017, which contains provisions for expediting the movement, release and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues. It further contains provisions for technical assistance and capacity building in this area. According to WTO estimations, the full implementation of the TFA could reduce trade costs by an average of 14.3% and boost global trade by up to USD 1 trillion per year, with the biggest gains in the poorest countries (WTO, 2016).

Significant progress has been made in the implementation of the agreement and 62.5% of commitments are implemented as of July 2019. Three members of the WTO from TC region show different patterns. While Turkey implemented all its commitments, Kazakhstan implemented 44.1% and Kyrgyzstan only 12.2% (Table 3.8).

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

In order to increase trade among the TC MCs, special attention should be paid to trade facilitation. This is required to connect with regional supply and value chains and to become part of sourcing, production and distribution networks within the region. It is beyond the capacity of this report to deliberate on specific trade facilitation measures. However, in order to assess the

performance of the member countries and identify the needs for further improvement, global databases are used.

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

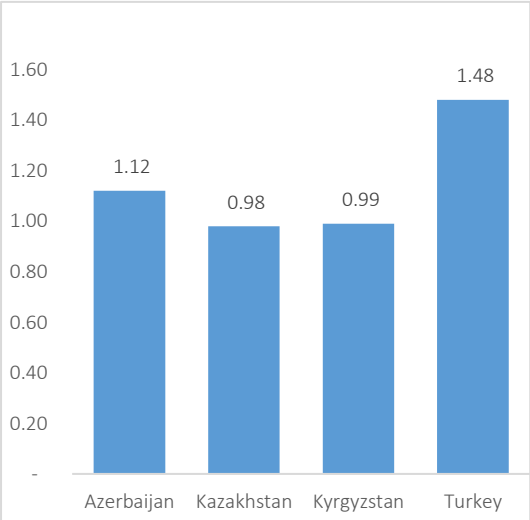
Table 3.8: TFA Agreement Rate of Implementation Commitments

	KAZ	KGZ	TUR
Rate of implementation - commitments to date across categories	44.1%	12.2%	100%
Rate of implementation - commitments by February 2023 without capacity building support	23.5%	16.4%	
Rate of implementation - commitments by February 2023 upon receipt of capacity building support	32.4%	71.4%	

Source: TFA Database, WTO.

There are eleven TFIs that take values from 0 to 2, where 2 designates the best performance that can be achieved. Figure 3.12 shows the average trade facilitation performance of TC MCs. Turkey has the highest score with 1.48, indicating that it made the most progress in facilitating trade. With an average score of 1.12, Azerbaijan shows a moderate performance in trade facilitation. Kyrgyzstan and Kazakhstan need to focus more attention to specific aspects of trade facilitation to improve their overall trade facilitation performance.

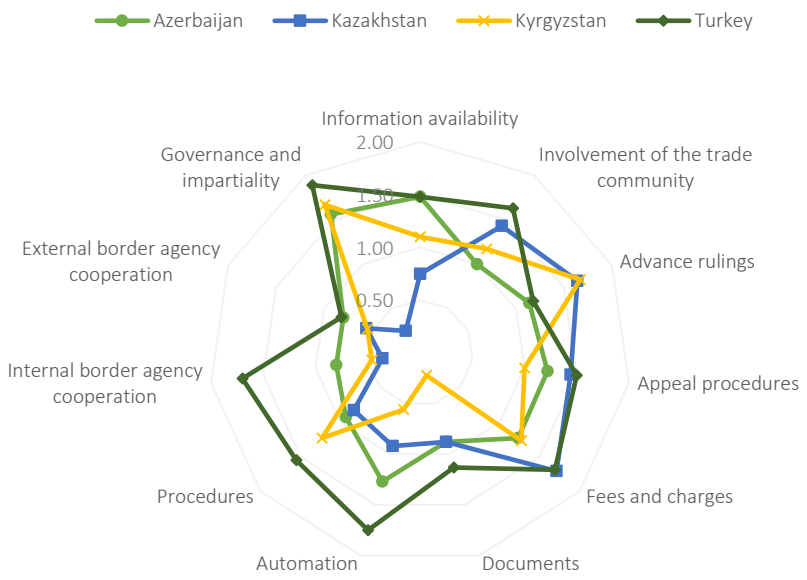
Figure 3.12: Average Trade Facilitation Performance



Source: OECD.

When we look at the specific indicators of trade facilitation, we observe that Turkey performs better than any other TC MC in eight indicators, where the highest performance is observed in governance and impartiality indicator (1.89). Documents (1.13) and advanced rulings (1.18) appear to be the weakest indicators for Turkey that needs to be improved (Figure 3.13). Turkey could tap into potentials of higher trade flows and lower trade costs by encouraging the use of the advance rulings systems, expanding the coverage of the Single Window, and making all forms and

Figure 3.13: Trade Facilitation Indicators



Source: OECD.

documents required for border procedures and for advance rulings available online, among others.

Kazakhstan shows strong performance in fees and charges indicator (1.71) and relatively better performance in advance rulings indicator (1.64) compared to other TC MCs. However, it appears to have challenges in the areas of governance and impartiality (0.25), internal border agency cooperation (0.36) and external border agency cooperation (0.56). Information availability (0.75), procedures (0.83) and documents (0.88) also require attention for further improvement (Figure 3.13). The performance gaps in these areas are huge compared to Turkey and other OECD countries. In order for Kazakhstan to reach best performance in these areas, it needs to reduce the number of documents required for import and export and the time necessary to prepare such documents, lower the number and types of fees and charges collected, complete the development of the Single Window, and reduce the average clearance time.

As a lower-middle income country, Kyrgyzstan can make substantial progress by narrowing the gaps in trade facilitation indicators. It has the highest score in advance rulings indicator of trade facilitation (1.67) and perform relatively well in governance and impartiality indicator (1.67), which reflects the capability of the country in reaching best performance. However, major challenges are obvious in documents (0.22), internal border agency cooperation (0.46), external border agency cooperation (0.55) and automation (0.56). In this connection, Kyrgyzstan should reduce the number of documents required for import and export and the time necessary to prepare such documents, improve the capacity of IT systems to exchange data electronically, consider the development of a Single Window and expand cooperation with internal and external border agencies.

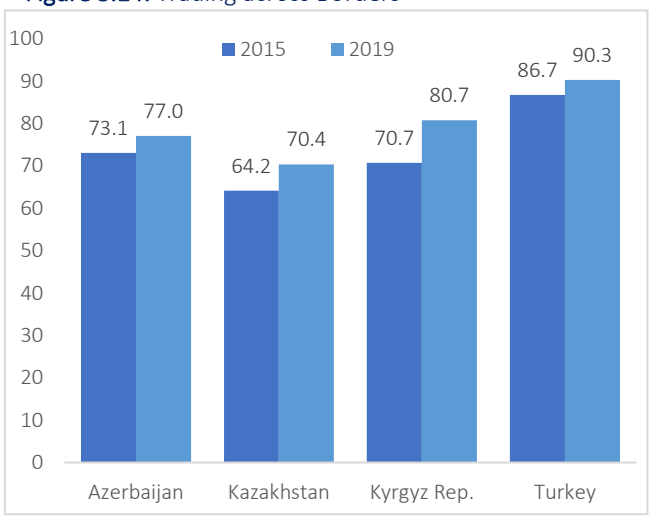
Azerbaijan performs relatively better in governance and impartiality (1.56) and information availability (1.48). The weakest indicators are internal border agency cooperation (0.80), external border agency cooperation (0.80) and documents (0.88). In order to reach its best performance, Azerbaijan needs to reduce the average clearance time, introduce pre-arrival processing of import documentation, and further simplify procedures and documentations in terms of associated time and costs and harmonise them in accordance with international standards.

Evidently, there are some common challenges faced by member countries in facilitating trade. Internal border agency cooperation is among the weakest indicators of trade facilitation within the TC region, indicating low levels of control delegation to customs agencies and lack of cooperation between various border agencies of the country. Effective communication among border agencies would increase operational efficiency and facilitate legitimate trade by removing redundant or sequential controls and duplicative documentation requirements (OECD, 2018). This could be achieved through open communication amongst relevant agencies, supported by clear delineation of responsibilities and clear frameworks for data sharing.

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

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

Figure 3.14: Trading across Borders



Source: World Bank Doing Business Database.

Figure 3.14 shows the progress of TC MCs in improving their trading across borders performance between 2015 and 2019 (comparison with earlier results is not possible due to a change in the methodology in DB). All

member countries could improve their performance in trading across borders thanks a series of reforms undertaken by them. Figure 3.15 summarizes the policy reforms that are found to be important to be included to the respective DB reports since 2008. Every country introduced new measures to facilitate trade across borders through various reforms, but most reforms were recorded for the year 2019. Continuation of this trend will not only facilitate trade among the member countries of the TC, but also with other countries as well.

Logistics Performance Index

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

Overall assessment of LPI shows that Turkey has better performance in logistics compared to other TC MCs (Figure 3.16). However, its performance is declining since 2014 and fell below the average of Europe and Central Asia. Kazakhstan has been improving its performance since 2012, which reached to 2.8 in 2018. Noting the fact that the data for Azerbaijan is available only until 2014, its performance remain below Kazakhstan. When we look at the sub-components of the LPI, competence and quality of logistics services also remain largely moderate and below the average of ECS (Figure 3.17). Turkey again outperforms other TC MCs, but remains below the average of ECS.

Figure 3.15: Achievements by TC MCs in Improving Trade across Borders

2008-2010

- **[2008] Turkey** made trading across borders easier by introducing an electronic data interchange system, improving information technology infrastructure and training some 2,500 customs officers and 14,000 traders.
- **[2010] Azerbaijan** reduced the clearance and border crossing time for goods by streamlining and regrouping agencies behind a single customs service window.
- **[2010] Kyrgyz Republic** made trading across borders easier and less time consuming by eliminating some previously required documents and simplifying inspection procedures.

2011-2015

- **[2011] Kazakhstan** speeded up trade through efforts to modernize customs, including implementation of a risk management system and improvements in customs automation.
- **[2014] Azerbaijan** made trading across borders easier by streamlining internal customs procedures.
- **[2015] Kazakhstan** made trading across borders easier by opening a new border station and railway link that helped reduce congestion at the border with China.

2017

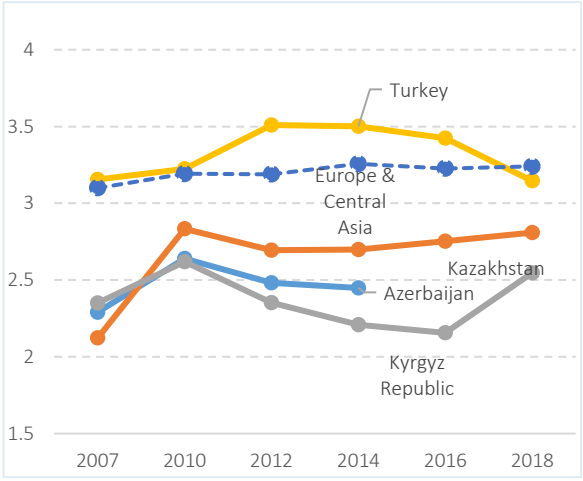
- **Azerbaijan** facilitated international trade processes by introducing an electronic system for submitting export and import declarations.
- **Kazakhstan** made exporting less costly by removing two export documents required for customs clearance.
- **Kyrgyz Republic** decreased time and cost for exporting by becoming a member of the Euroasian Economic Union.

2019

- **Azerbaijan** made trading across borders faster by streamlining electronic customs procedures and fully implementing the "green corridor" gating system.
- **Kazakhstan** made trading across borders easier by introducing an electronic customs declaration system, ASTANA-1 IS, as well as reducing customs administrative fees.
- **Kyrgyz Republic** made trading across borders easier by streamlining exports within the Eurasian Economic Union.
- **Turkey** reduced the time and cost to export and import through various initiatives, incl. expanding the functionalities of the national trade single window, enhancing the risk management system and lowering customs brokers' fees.

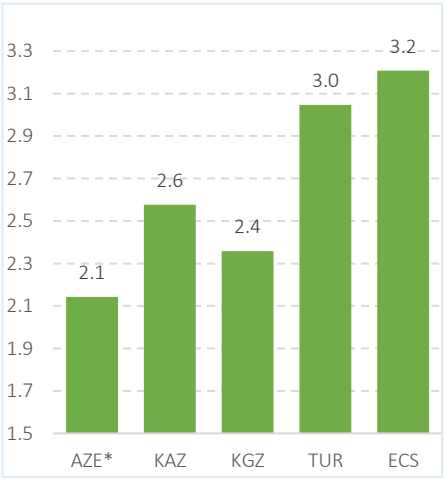
Source: World Bank.

Figure 3.16: Logistics Performance Index: Overall



Source: World Bank LPI Database. Note: 1=low to 5=high.

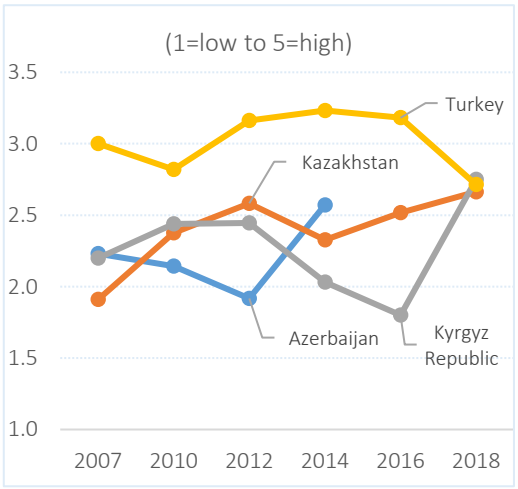
Figure 3.17: LPI: Competence and Quality of Logistics Services



Source: World Bank LPI Database. (*) 2014 data. 1=low to 5=high)

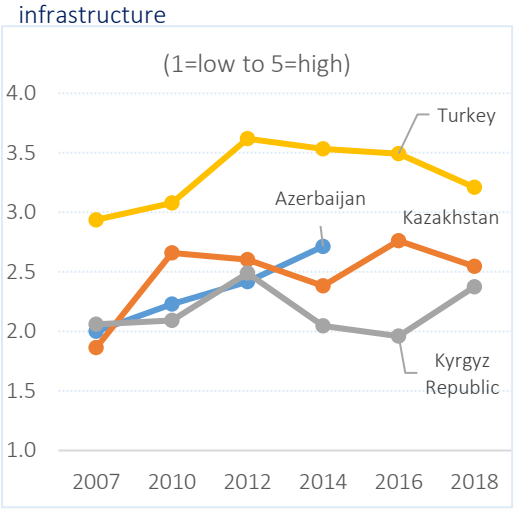
Another sub-component of the LPI is efficiency of customs clearance process and quality of trade and transport-related infrastructure. In both of these indicators, Turkey has been attaining higher scores compared to other countries. However, scores in efficiency of customs clearance process almost equalized in 2018 owing to a sharp decline in the performance of Turkey and great achievements made by Kyrgyzstan. Noting the subsequent falls in the scores of Turkey over the last couple of years, it would be advisable for Turkey to review its shortcomings and challenges in improving the logistics performance and address them to prevent further deterioration of index values.

Figure 18: Logistics Performance Index: Efficiency of customs clearance process



Source: WB WDI Database.

Figure 19: Logistics Performance Index: Quality of trade and transport-related infrastructure



Source: WB WDI Database.

4 Analysis of Intra-Regional Trade Potential

Turkic Council Member Countries (TC MCs) have commonalities in many areas that would positively affect the economic and commercial cooperation among the member countries. However, various factors lead to underutilization of potential economic partnership opportunities within the region. This section attempts to identify the trade potentials among the TC MCs and analyse the potential impacts of greater economic cooperation on the bilateral trade flows.

4.1 Trade Potentials among the Turkic Council Countries

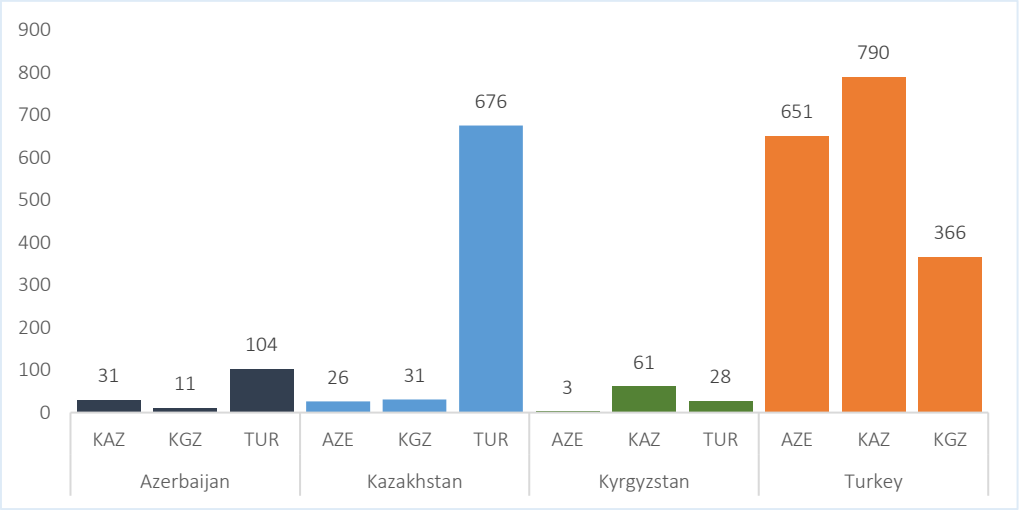
There is a strong correlation and interdependence between trade and economic growth. Exports increase the exposure of local firms to international competition and force them to learn the state-of-the-art technology and systems and engage in innovative approaches. Greater capacity to export support job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

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

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

The ITC follows a quantitative approach to identify promising export sectors and markets on a global scale, based on tangible and measurable trade and market access data and information. Although, unmeasurable or intangible factors, along with recent events affecting bilateral and multilateral relations, could also affect the calculated export and diversification measures, and thus the prioritization of products and markets, they are not taken into consideration due to their immeasurability. The EPI thereby identifies products in which the exporting country has already proven to be internationally competitive and which have good prospects of export success in new

Figure 4.1: Untapped Export Potentials (Million USD)

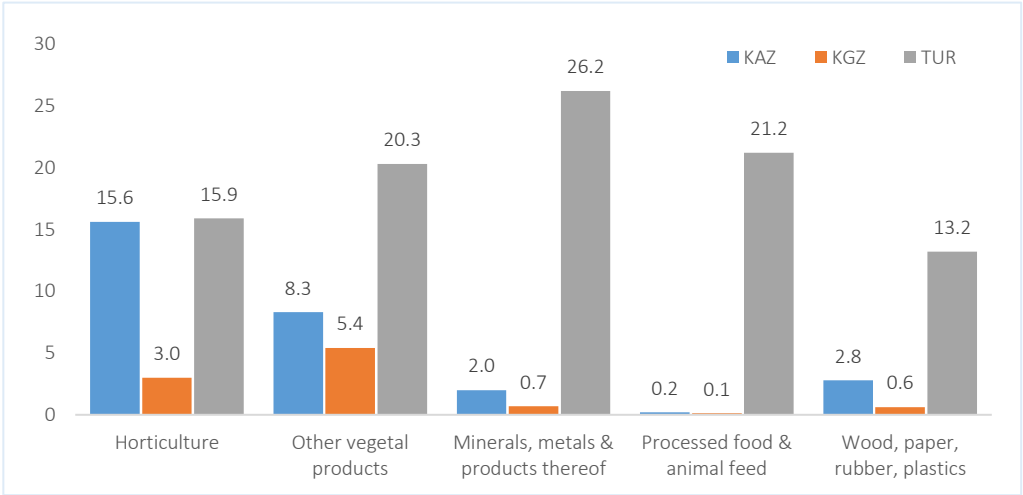


Source: International Trade Centre, Export Potential Map.

or existing target markets. It also helps to identify niche products of sectors that are not on top of the ranking but could allow for more trade, economic development or poverty reduction.

There are also significant gaps between what individual TC MCs could export and what they actually export. Figure 4.1 shows the gap between what countries could export and they actually export. Azerbaijan has the largest untapped export potential with Turkey. They could export more than USD 100 million worth of products to Turkey in addition to what it currently exports. Its untapped potential with Kazakhstan and Kyrgyzstan is relatively lower, with USD 31 million and USD 11 million, respectively.

Figure 4.2: Azerbaijan: Top Five Sectors with Untapped Export Potentials (Million USD)



Source: International Trade Centre, Export Potential Map.

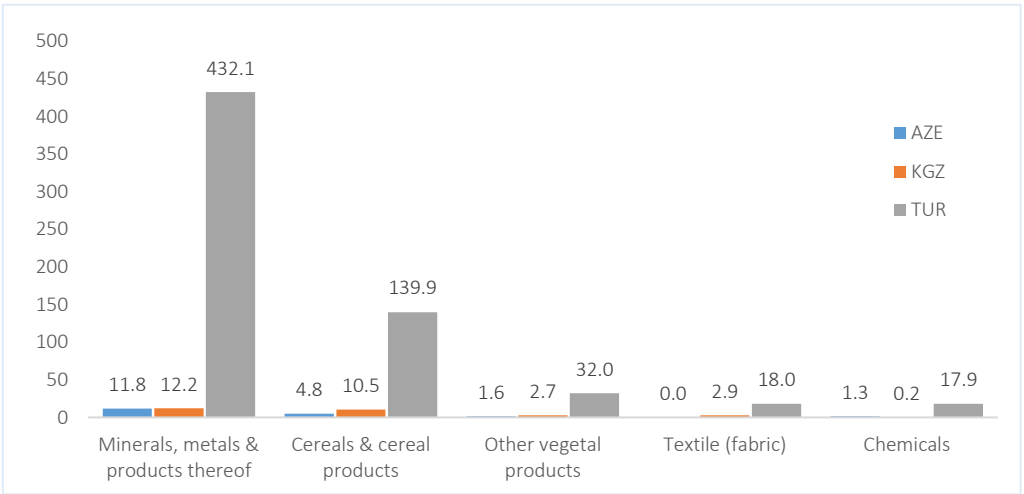
Kazakhstan also misses a significant export potential with Turkey. It could export USD 676 million worth of products if factors that prevent the utilization of these potentials. On the other hand, Kazakhstan appears to almost fully utilize its export potentials with Azerbaijan and Kyrgyzstan, where there are only USD 26 million and USD 31 million untapped export potential, respectively. The Kyrgyz Republic have the lowest magnitude of untapped export potential, which is largely due to smaller size of the economy. However, it could export USD 61 million worth of products more than what it actually exports to Kazakhstan, USD 28 million more to Turkey and USD 3 million more to Azerbaijan.

Turkey falls short of utilizing a significant amount of export potential with other TC MCs. There is a gap of USD 651 million with Azerbaijan, USD 790 million with Kazakhstan and USD 366 million with Kyrgyzstan between what it exports and what it could export to these countries. In total, Turkey experiences more than USD 1.7 billion untapped export potential. Noting the fact that Turkey export USD 2.5 billion worth of goods to TC MCs, Turkey basically misses around 40% of potential exports to other TC MCs. This figure was around 26% for Kazakhstan, around 23% for Kyrgyzstan and around 8% for Azerbaijan.

Analyses on export potentials can be further expanded to sectoral and product level to see the products with highest export potentials. With almost USD 35 million, horticulture constitute the largest untapped potential between Azerbaijan and other TC MCs, particularly with Kazakhstan and Turkey (Figure 4.2). It is followed by other vegetal products (USD 34 million, mainly with Turkey), minerals, metals and their products (USD 29 million, mainly with Turkey) and processed food and animal feed (USD 21.5 million, mainly with Turkey).

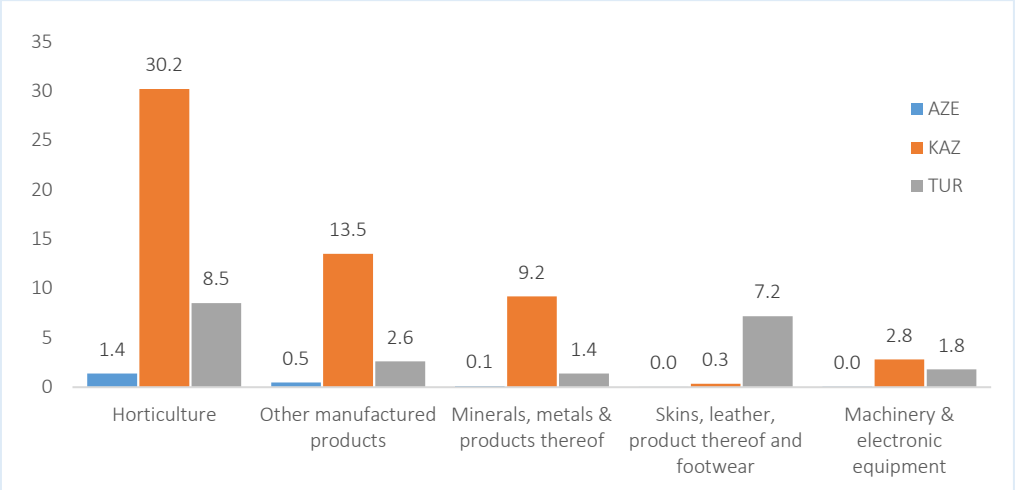
Kazakhstan's untapped export potential lies mainly in mineral, metals and their products (Figure 4.3). It could export USD 454 million more of these products to other TC MCs, particularly to Turkey. Turkey also remains the main partner with largest untapped export potentials in other sectors. In cereals products, there is an opportunity to trade USD 155 million more, mainly with

Figure 4.3: Kazakhstan: Top Five Sectors with Untapped Export Potentials (Million USD)



Source: International Trade Centre, Export Potential Map.

Figure 4.4: Kyrgyzstan: Top Five Sectors with Untapped Export Potentials (Million USD)



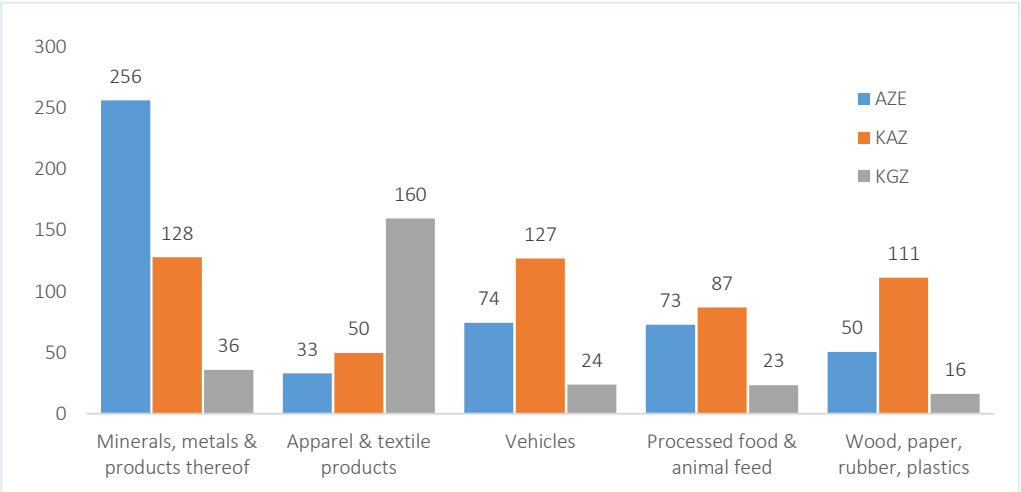
Source: International Trade Centre, Export Potential Map.

Turkey. Kazakhstan has an opportunity to export more than USD 36 million worth of other vegetal products.

As in the case of Azerbaijan, horticulture constitute the largest untapped export potential for Kyrgyzstan with over USD 40 million, mainly with Kazakhstan (Figure 4.4). Other manufactured products (USD 16.6 million, mainly with Kazakhstan), minerals, metals and their products (USD 10.7 million, mainly with Kazakhstan) and skins, leather and their products ((USD 7.5 million, mainly with Turkey) reveal high untapped export potentials for Kyrgyzstan with other TC MCs.

The main sector for Turkey with highest untapped export potential is minerals, metals and their products (Figure 4.5). It constitutes USD 420 million additional export potential for Turkey, mainly

Figure 4.5: Turkey: Top Five Sectors with Untapped Export Potentials (Million USD)



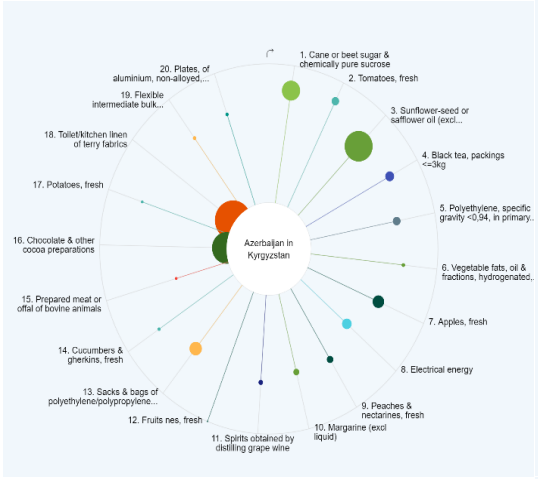
Source: International Trade Centre, Export Potential Map.

with Azerbaijan and Kazakhstan. Apparel and textile products (USD 242 million, mainly with Kyrgyzstan), vehicles (USD 225 million, mainly with Kazakhstan and Azerbaijan), processed food and animal feed (USD 183 million, mainly with Kazakhstan and Azerbaijan) and wood, paper, rubber and plastics (USD 178 million, mainly with Kazakhstan) are the other sectors where great export potentials lie for Turkey in other TC MCs.

In addition to sectoral level analysis, Figures 4.6-4.9 shows the products with most export potentials for individual TC MCs. The following top five products are found to have the highest export potential in each market:

- Azerbaijan
    - *In Kazakhstan:* (i) cane or beet sugar & chemically pure sucrose, (ii) tomatoes, (iii) fresh fruit, nes.
    - *In Kyrgyzstan:* (i) cane or beet sugar & chemically pure sucrose, (ii) tomatoes, (iii) sunflower seed or safflower oil
    - *In Turkey:* (i) polyethylene in primary forms, (ii) aluminium, not alloyed, unwrought (iii) semi-finished products of iron or steel
- Kazakhstan
    - *In Azerbaijan:* (i) wheat (excl. durum) and meslin, (ii) flat-rolled products of iron or non-alloy steel, (iii) durum wheat
    - *In Kyrgyzstan:* (i) wheat (excl. durum) and meslin, (ii) wheat or meslin flour, (iii) waters as beverage
    - *In Turkey:* (i) copper cathodes, (ii) aluminium, not alloyed, unwrought (iii) wheat (excl. durum) and meslin
- For Kyrgyzstan
    - *In Azerbaijan:* (i) filament lamps (ii) kidney beans, dry and shelled (iii) walnuts, shelled
    - *In Kazakhstan:* (i) float glass, nes, in non-wired sheets (ii) calcareous stone (iii) milk
    - *In Turkey:* (i) kidney beans, dry and shelled (ii) cotton, not carded/combed (iii) walnuts, shelled
- For Turkey
    - *In Azerbaijan:* (i) Line pipe used for oil and gas pipelines, (ii) bars and rods of iron or non-alloy steel (iii) sanitary articles
    - *In Kazakhstan:* (i) motor vehicles for the transport of persons, nes, (ii) sanitary articles (iii) floor coverings of man-made textiles, made up
    - *In Kyrgyzstan:* (i) men's trousers & shorts of cotton (ii) t-shirts & vests of cotton, knit/crochet (iii) hosiery, knit/crochet

Figure 4.6: Azerbaijan: Products with Most Export Potential



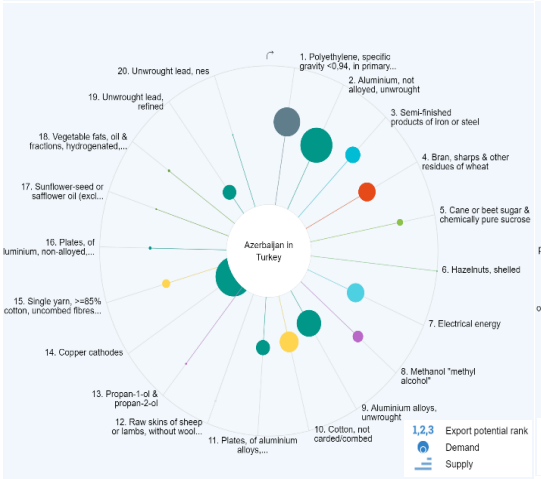
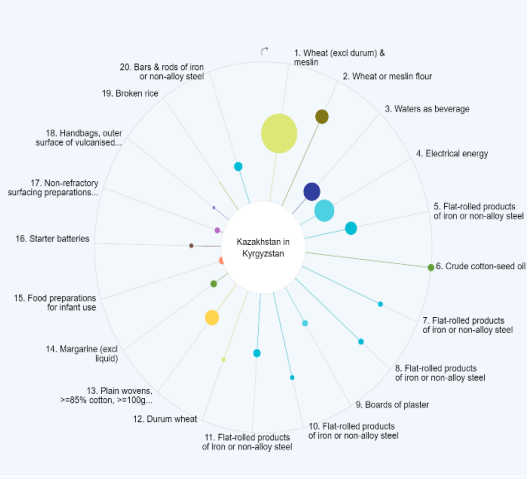
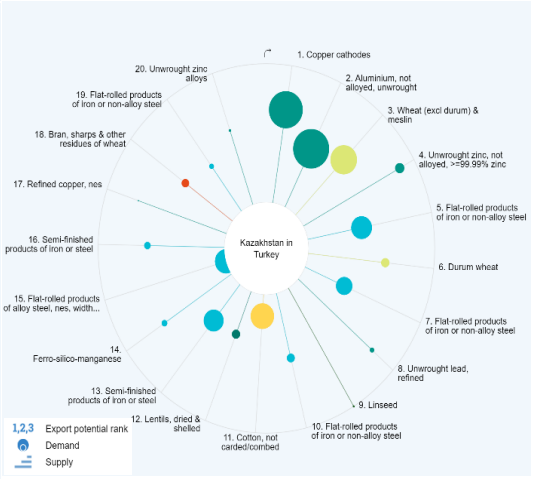


Figure 4.7: Kazakhstan: Products with Most Export Potential





Source: International Trade Centre, Export Potential Map.

Figure 4.8: Kyrgyzstan: Products with Most Export Potential

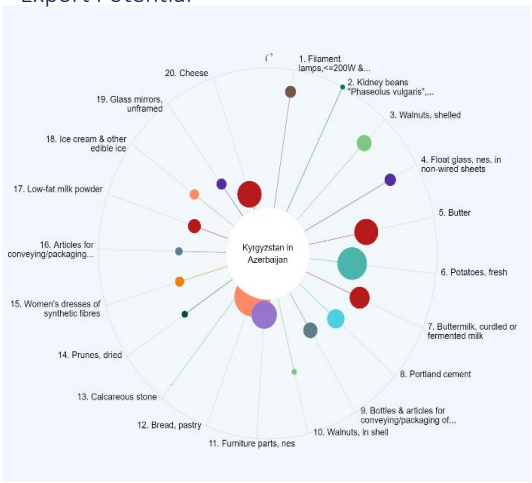
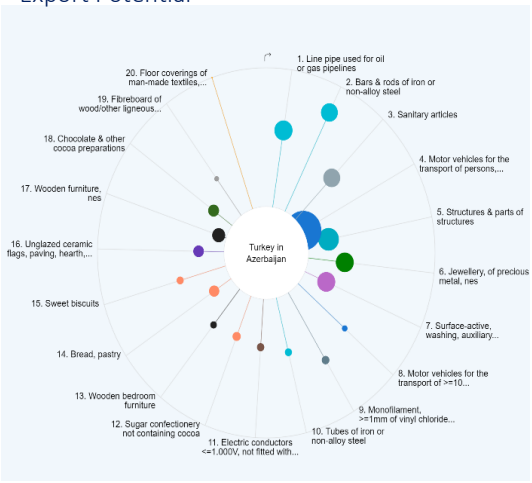
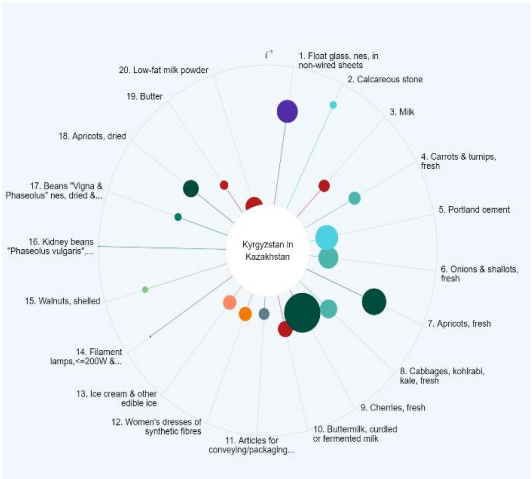
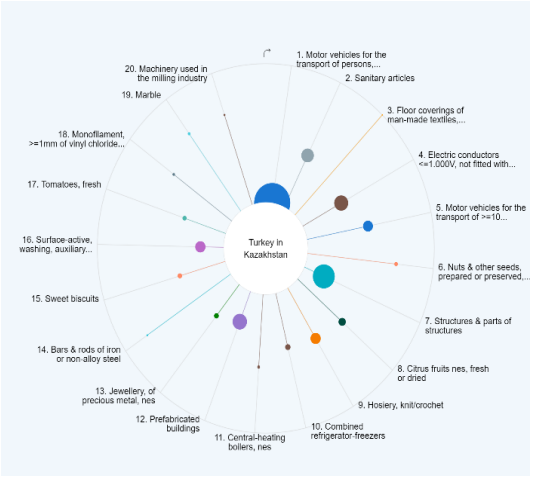
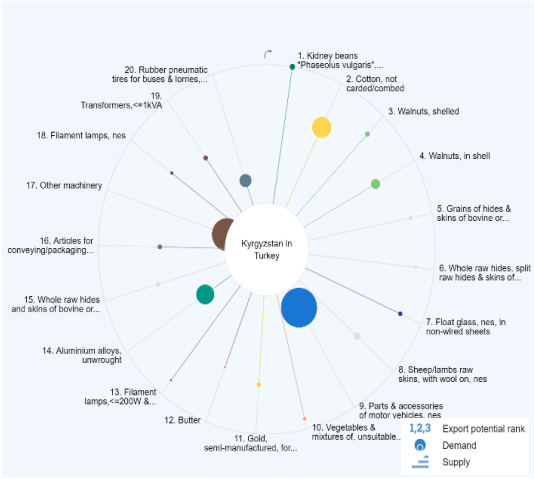


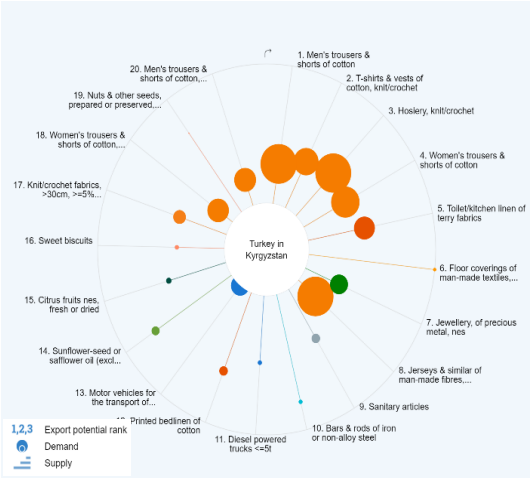
Figure 4.9: Turkey: Products with Most Export Potential











Source: International Trade Centre, Export Potential Map.

These products are the top products with highest export potential in each market However, it does not indicate the gap between actual and potential exports. Some countries may be utilizing these potentials, but in most cases, there are large gaps between actual exports and potential exports. Therefore, trade advisors in the member counties should further investigate the products and sectors where there are great export potentials and encourage their exporters to enter into the markets of other member countries. This may require negotiations with relevant authorities to reduce any barriers that may exist for exporters.

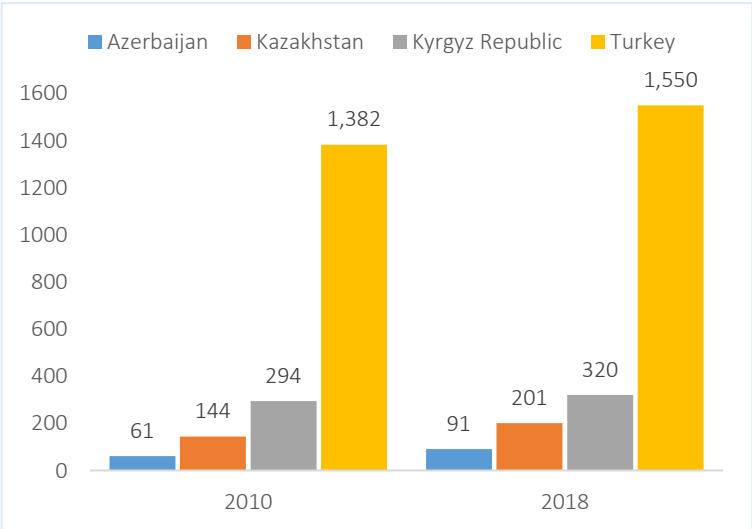
4.2 Comparative Advantages and Trade Complementarities at Commodity Level

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

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

We calculated the RCA values at 6 digit international trade classification to find out the number of products that each TC MC has comparative advantage. In order to compare the performance of countries over time, this calculation is made for 2010 and 2018. As shown in Figure 4.10, Azerbaijan had comparative advantage in 61 products in 2010, but it

Figure 4.10: Comparative Advantages of TC MCs: Number of Products



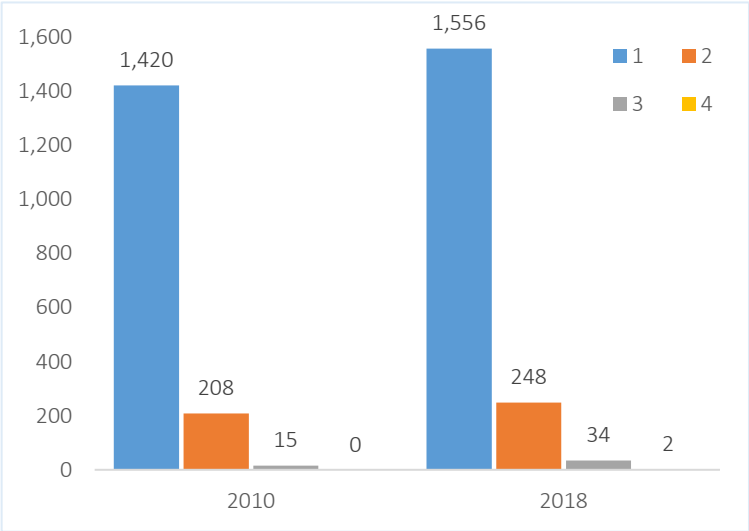
Source: SESRIC staff calculations based on UN Comtrade Database.

achieved to increase this number to 91 in 2018. Kazakhstan had comparative advantage in 144 products in 2010 and it managed to have comparative advantage in 201 products in 2018. Similarly, Kyrgyzstan successfully increased the number of products in which it has comparative advantage from 294 in 2010 to 320 in 2018.

The highest number of products with comparative advantage was observed in Turkey. It had comparative advantage in 1382 products in 2010 and it could further increase it to 1550 in 2018. Calculations were made by using the data for 4938 products listed under 6 digit level reported according to Harmonized System (HS) 2007. In this connection, ability of Turkey to have comparative advantage in more than 30% of all products shows particular strength of Turkish economy in international trade. This also explains the greater export potential of Turkey in other markets compared to other countries in the region.

In connection with improving intra-regional trade, an important question would be whether the comparative advantages that each member country overlaps with each other. If countries have comparative advantage in the same products, the prospects for trade complementarity between the countries will be lower. Figure 4.11 shows the number of products where TC MCs have comparative advantage, disaggregated by number of countries having comparative advantage. In the extreme cases, the number of products where all TC MCs have comparative advantage would be 91 in year 2018. However, there are only 2 products where all countries have comparative advantage in the same product. The number of products where three of the TC MCs have simultaneously comparative advantage would be maximum 201, but there were only 34 products where at three TC MCs have comparative advantage. These results imply that comparative advantages do not constrain trade complementarities significantly. When we look at the number of products where two TC MCs have comparative advantage at the same time, we observe 248 products with such property. Noting the fact that the highest possible number would be 320 for two countries to have comparative advantage at the same time, 248 can be considered relatively high, which may have some implications in promoting intra-regional trade.

Figure 4.11: Comparative Advantages of TC MCs: Number of Same Products

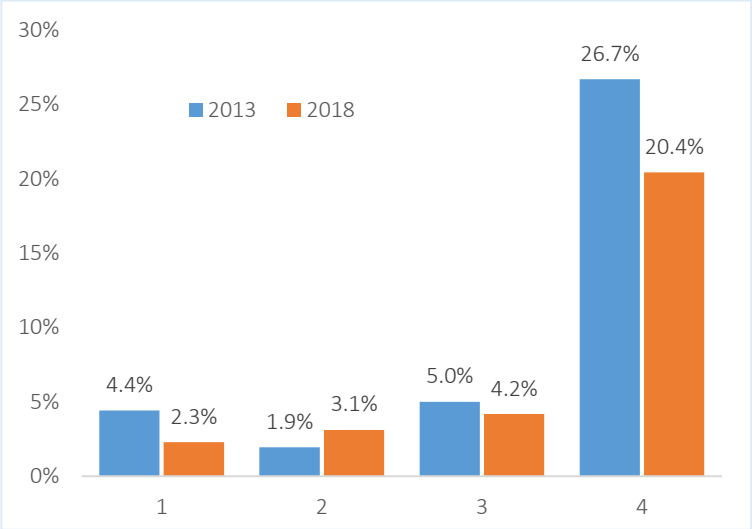


Source: SESRIC staff calculations based on UN Comtrade Database.

In order to see how intra-regional trade is shaped by comparative advantages that the member countries have, we calculated the share of intra-

regional trade in products where countries have comparative advantage. In 2018, only 2.3% of trade was realized among the TC MCs in products where only one country has comparative advantage (Figure 4.12). This is relatively low, indicating underutilization of comparative advantages in intra-regional trade. The share of intra-regional trade in goods where two of the TC MCs have comparative advantage was 3.1% and in goods where three TC MCs have comparative advantage was 4.2%. Interestingly, the share of intra-regional trade increases in products where more countries have comparative advantage at the same time. The list of products where three TC MCs have comparative advantage is provided in Table 4.1. These products are mainly raw or processed agricultural and mineral products.

Figure 4.12: Intra-TC Trade in Products with Comparative Advantages



Source: SESRIC staff calculations based on UN Comtrade Database.

More astonishingly, intra-regional export in products where all countries have comparative advantage reaches 20.4%. The two products that all TC MCs have comparative advantage are black tea and cotton (not carded or combed). The high share of intra-regional trade in these two products can be mainly explained by high cotton exports of Azerbaijan to Turkey. Even if Turkey has comparative advantage in cotton products, its highly developed textile industry may require more cotton to process and re-export them.

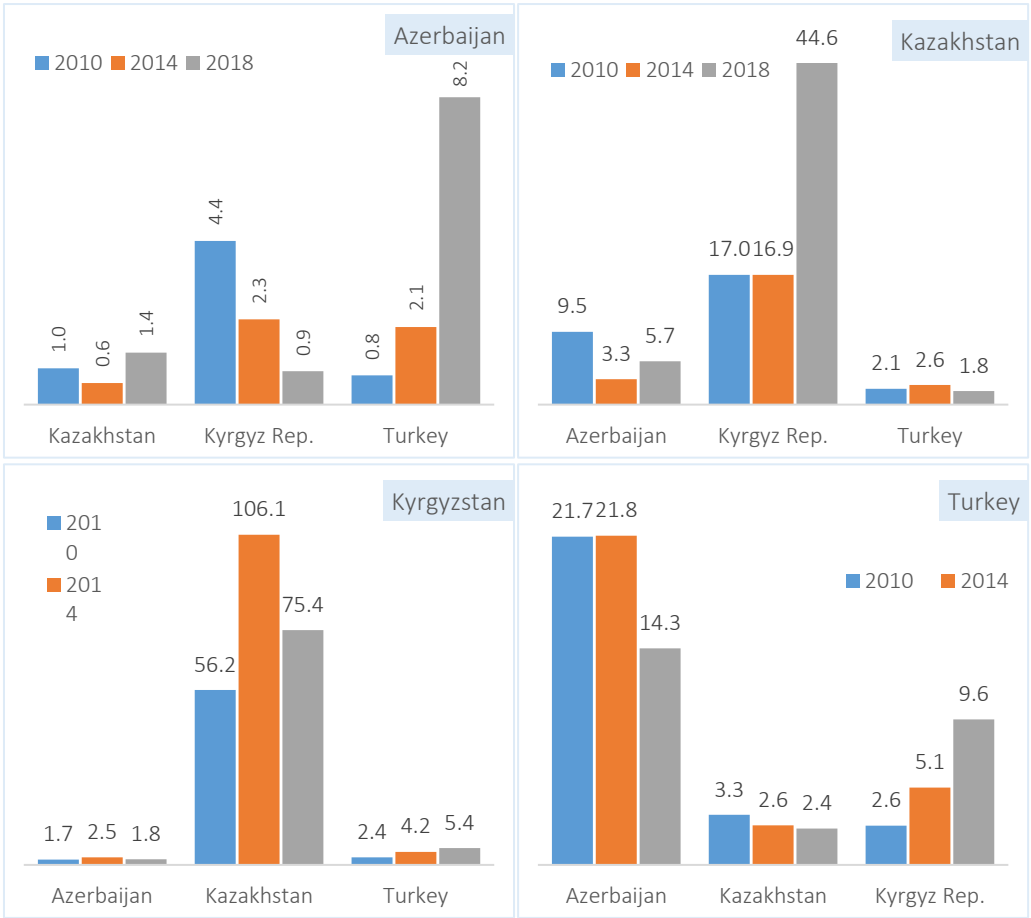
The trade intensity index (TII) uses similar logic to that of revealed comparative advantage, but for markets rather than products. It indicates whether a reporter exports more, as a percentage, to a partner than the world does on average. It is measured as country i's exports to country j relative to its total exports divided by the world's exports to country j relative to the world's total exports. If the TII equals 1, trade partners are trading without geographic bias. Values above (below) 1 indicates the trade between two countries is more (less) intensive than expected. Azerbaijan's trade intensity with Kyrgyzstan is falling over the years and reached below 1 in 2018, indicating a weaker trade relation compared to world average. However, its relations with Turkey is steadily improving over the years to reach 8.2 in 2018 (Figure 4.13).

Table 4.1: List of Products where Three TC MCs have Comparative Advantage			
070190	Vegetables; potatoes (other than seed), fresh or chilled	252329	Cement; portland, other than white, whether or not artificially coloured
071340	Vegetables, leguminous; lentils, shelled, whether or not skinned or split, dried	261690	Precious metal ores and concentrates; (excluding silver)
080810	Fruit, edible; apples, fresh	310559	Fertilizers, mineral or chemical; containing the two fertilizing elements nitrogen and phosphorus, other than nitrates and phosphates
080910	Fruit, edible; apricots, fresh	410411	Tanned or crust hides and skins; without hair on, bovine or equine, in the wet state (including wet blue), full grains, unsplit; grain splits
080920	Fruit, edible; cherries, fresh	410510	Tanned or crust skins of sheep and lambs, without wool on, whether or not split, but not further prepared, in the wet state
080930	Fruit, edible; peaches including nectarines, fresh	510121	Wool; (not carded or combed), degreased, (not carbonised), shorn
080940	Fruit, edible; plums and sloes, fresh	510129	Wool; (not carded or combed), degreased, (not carbonised), (other than shorn)
081090	Fruit, edible; fruits n.e.c. in heading no. 0801 to 0810, fresh	520210	Cotton; yarn waste (including thread waste)
121190	Plants and parts (including seeds and fruits) n.e.c. in heading no. 1211, used primarily in perfumery, pharmacy or for insecticidal, fungicidal purposes; fresh or dried, whether or not cut, crushed or powdered	520512	Cotton yarn; (not sewing thread), single, of uncombed fibres, 85% or more by weight of cotton, less than 714.29 but not less than 232.56 decitex (exceeding 14 but not exceeding 43 metric number), not for retail sale
151219	Vegetable oils; sunflower seed or safflower oil and their fractions, other than crude, whether or not refined, but not chemically modified	680911	Plaster, or plaster compositions; boards, sheets, panels, tiles and similar articles, faced or reinforced with paper or paperboard only, not ornamented
151229	Vegetable oils; cotton-seed oil and its fractions, other than crude, whether or not refined, but not chemically modified	720720	Iron or non-alloy steel; semi-finished products of iron or non-alloy steel, containing by weight 0.25% or more of carbon
151710	Margarine; excluding liquid margarine	720890	Iron or non-alloy steel; flat-rolled, hot-rolled, of a width 600mm or more, n.e.c. in heading no. 7208
230230	Bran, sharps and other residues; of wheat, whether or not in the form of pellets, derived from the sifting, milling or other workings thereof	721420	Iron or non-alloy steel; bars and rods, hot-rolled, hot-drawn or hot-extruded, containing indentations, ribs, grooves or other deformations
230610	Oil-cake and other solid residues; whether or not ground or in the form of pellets, resulting from the extraction of cotton seed oils	721499	Iron or non-alloy steel; bars and rods, hot-rolled, hot-drawn or hot-extruded, n.e.c. in heading no. 7214, other than of rectangular cross-section
240110	Tobacco, (not stemmed or stripped)	740321	Copper; copper-zinc base alloys (brass) unwrought
240220	Cigarettes; containing tobacco	780199	Lead; unwrought, unrefined, not containing by weight antimony as the principal other element
251110	Barium sulphate (barytes); natural	860800	Railway or tramway track fixtures and fittings; mechanical signalling, safety or traffic control equipment for railways, tramways, roads, inland waterways, parking facilities, port installations or airfields; parts thereof
Source: Author's calculation based on UN COMTRADE database.			

For Kazakhstan, all TC MCs enjoy high trade intensity, indicating stronger trade relations of Kazakhstan with other TC MCs. Its strongest relation is with Kyrgyzstan, which reached 44.6 in 2018. This bilateral trade relations become even stronger when we look at from the perspective of the Kyrgyz Republic. Kazakhstan plays 75 times more importance for Kyrgyzstan than average country in the world. While Turkey's importance for Kyrgyzstan increases over time, Azerbaijan also remain an important trade partner for Kyrgyzstan with a TII score of 1.8. Turkey has also strong trade relations with all TC MCs, particularly with Azerbaijan. It has also a continuously improving trade intensity with Kyrgyzstan.

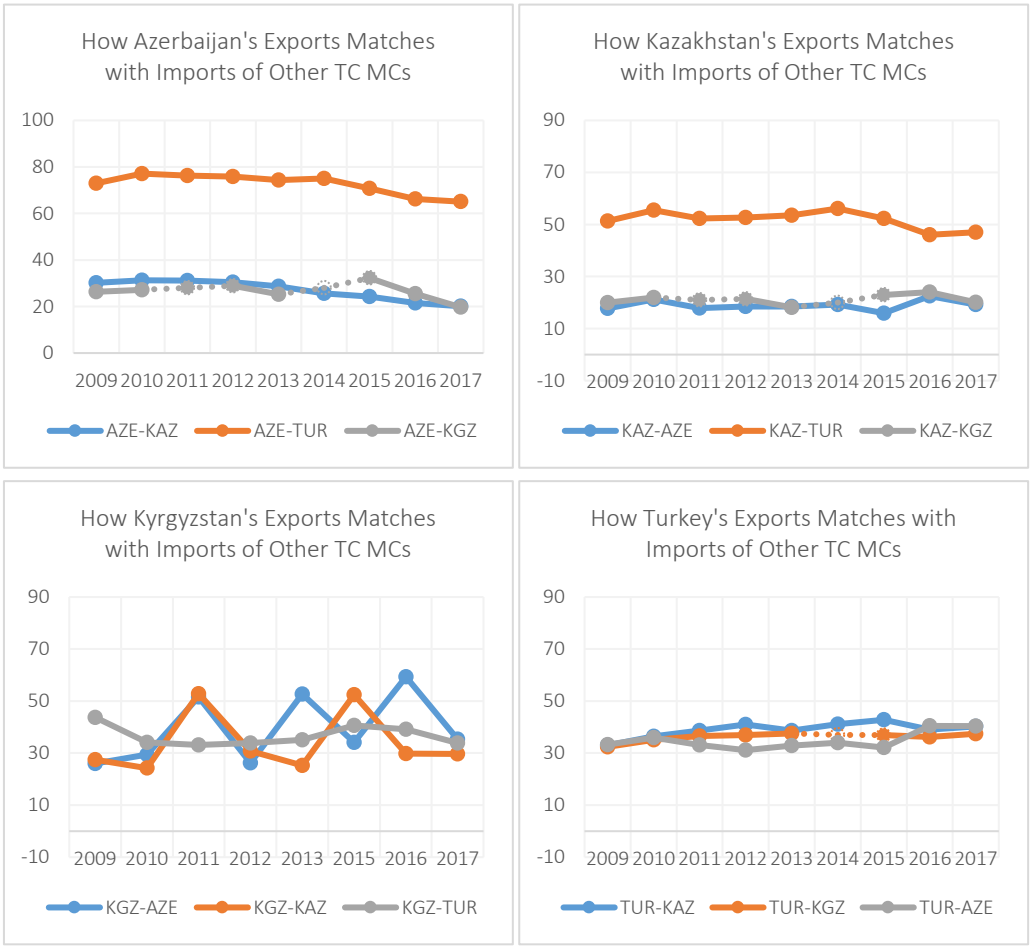
Although analyses on comparative advantages and trade intensities provide some insights on potential complementarities of bilateral trade, there are other tools that provide more information about complementarities and potential trade. An index developed for this purpose is trade complementarity index (TCI). The TCI indicates to what extent the export profile of the reporter matches, or complements, the import profile of the partner. In other words, it measures the extent to which two countries are "natural trading partners". The index takes the value of

Figure 4.13: Trade Intensities among the TC MCs



Source: World Bank WITS database.

Figure 4.14: Trade Complementarities among the TC MCs



Source: SESRIC staff calculations based on UN COMTRADE database.

zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match. A high index may indicate that two countries would stand to gain from increased trade and may be particularly useful in evaluating prospective bilateral or regional trade agreements.

Trade complementarity indices can be traced over time. Figure 4.14 shows the evolution of TCIs for TC MCs during the period between 2009 and 2017. Azerbaijan has the highest complementarity rate with Turkey, which also explains strong trade relations between the two countries. Turkey had 94% share in Azerbaijan's export to TC MCs in 2018 (see Figure 2.6a). However, the TCI value is falling over the last few years, indicating decreasing complementarity of trade. Trade of Azerbaijan with Kazakhstan and Kyrgyzstan seems to be less complementary, which have a TCI score of around 20 compared to 65 with Turkey in 2017. Export profile of Kazakhstan has the highest resemblance with the import profile of Turkey, where TCI was calculated at 47 in 2017. This also explains the higher share of trade between two countries. TCI

values for Azerbaijan and Kyrgyzstan are relatively lower and stand at 20 in 2017, indicating lower complementarity of trade between Kazakhstan and these two countries.

There is no particular country with strong complementarities with Kyrgyzstan's exports. There are significant fluctuations over time in TCI values for its trade with Azerbaijan and Kazakhstan, but they remain on average around the same values. As of 2017, complementarity scores between Kyrgyzstan and other TC MCs were around 30-34, reflecting moderate complementarity. Lack of complementarity between Kyrgyzstan and other TC MCs may explain lower trade volumes among these countries. A similar picture is observed in Turkey's trade complementarities with other TC MCs as well. Albeit slightly, there is an increasing complementarity of trade among the concerned countries over the years, but it remains relatively low. As of 2017, TCI for Turkey with its partners ranged between 37 and 40.

4.3 Impacts of Trade Facilitation Measures on Trade Volume

There is great trade potential between the member countries of the Turkic Council. However, effective utilization of this potential requires greater cooperation and collaboration towards reducing trade barriers and harmonization of policies. There are alternative forms of economic cooperation and integration. Preferential trade agreements are probably the most basic form of any regional economic integration. Customs union and monetary union are more advanced arrangement of economic integration.

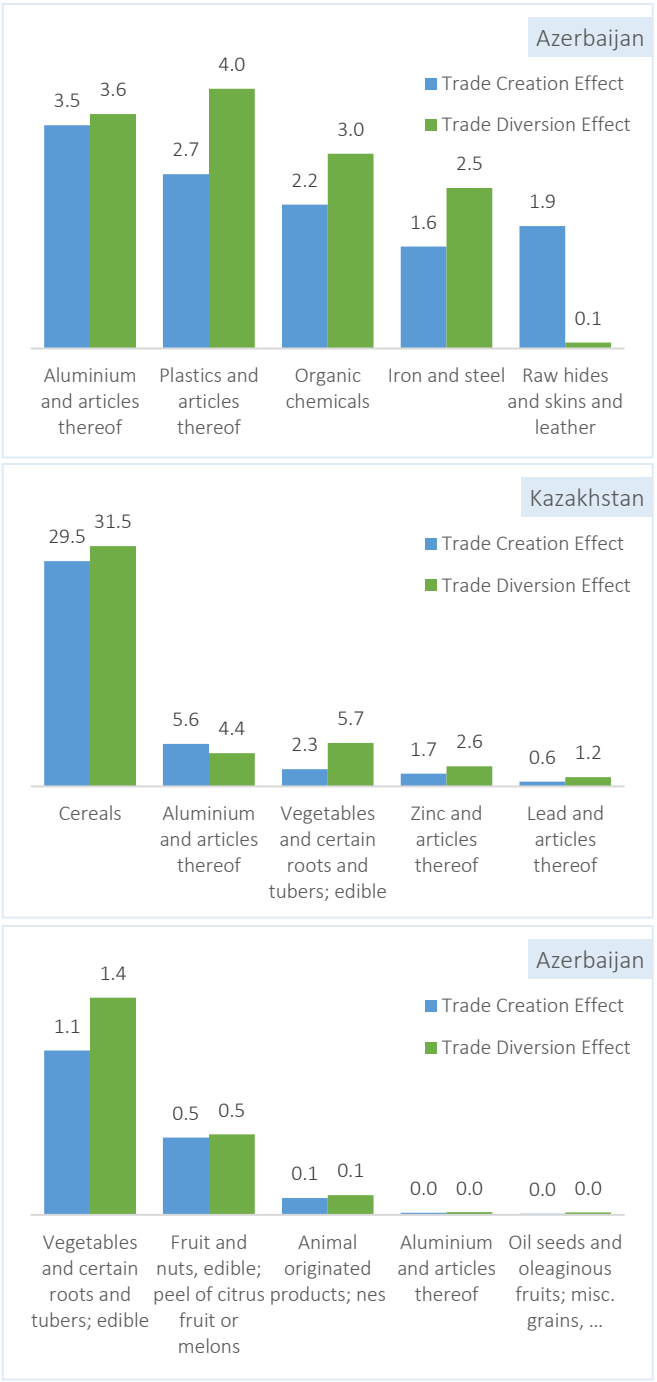
Turkic Council Member Countries could start with the most basic form of economic integration and enter into a preferential trade agreement. When countries form a regional trade agreement, they not only apply lower tariffs but also cooperate on a number of other policy areas that lead to a reduction in overall bilateral trade costs among member countries beyond the removal of explicit trade barriers. Therefore, the importance of such an agreement should not be underestimated.

Currently, Azerbaijan, Kazakhstan and Kyrgyzstan are part of the Commonwealth of Independent States (CIS) Free Trade Agreement, which entered into force in 1994. The contracting parties agreed not to apply customs duties, taxes and levies which have equivalent effect and quantitative restrictions to importation and/or exportation of goods originating in customs territory of one of the contracting parties and intended for customs territory of other contracting parties (WTO, 1999). Therefore, it envisaged no barriers to trade in terms of customs duties, taxes and levies. As we observed in section 3, tariff rates among these countries are zero, except very few products.

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

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

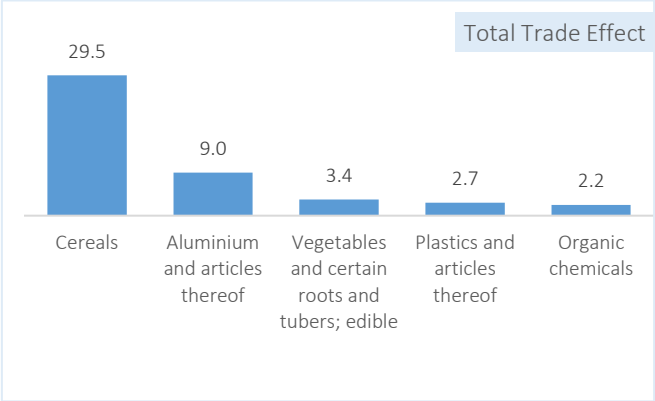
Figure 4.15: Impact of Free Trade between Turkey and Other TC MCs



Source: SESRIC staff calculations based on World Bank WITS SMART

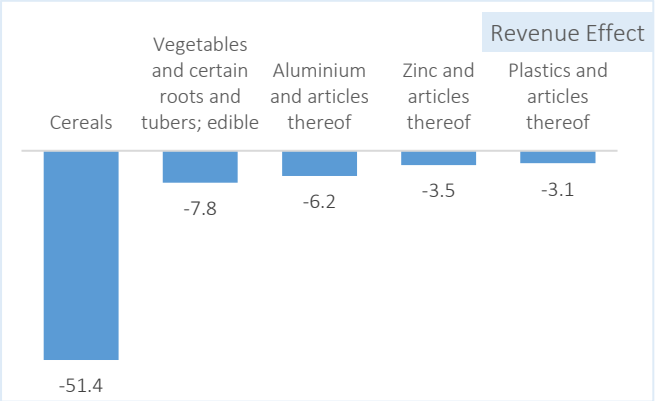
Most of the trade and investment agreements among Azerbaijan, Kazakhstan and Kyrgyzstan are shaped by their historical relationships within the CIS region. Turkey typically remains outside of these constellations. All TC MCs are also members of other regional organizations, such as the Organization of Islamic Cooperation (OIC), Economic Cooperation Organization (ECO) and Asian Development Bank (ADB). It is therefore necessary for the Turkic Council to decide how to promote regional integration among its Member States. First option would be to create a new free trade area among the its members, but noting the fact that three of the four members have already almost

Figure 4.16: Total Impact of Free Trade between Turkey and Other TC MCs, by Sectors



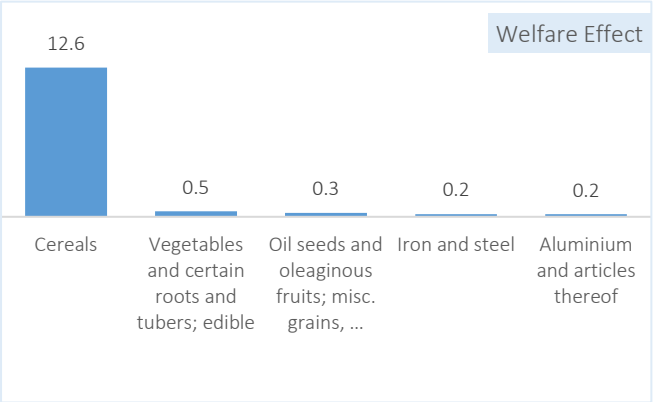
Source: SESRIC staff calculations based on World Bank WITS SMART Module

Figure 4.17: Total Impact of Free Trade between Turkey and Other TC MCs, by Sectors



Source: SESRIC staff calculations based on World Bank WITS SMART

Figure 4.18: Total Impact of Free Trade between Turkey and Other TC MCs, by Sectors



Source: SESRIC staff calculations based on World Bank WITS SMART

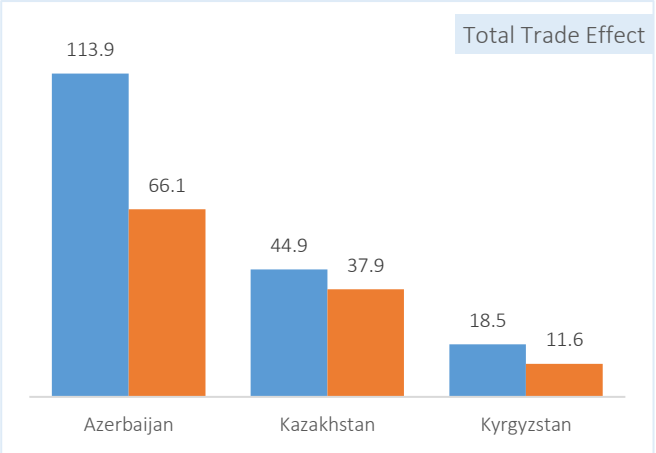
no tariff barriers among them, such an option may not be the optimum scenario. Alternatively, one of the existing trade agreement could be extended to cover all TC MCs. This could be less burdensome for the parties, but one or more TC MCs may not be willing to enter into a free trade agreement with a non-TC MCs as part of such practices.

It may still be desirable to create a FTA within the TC region, with further ambition to form a customs union to further reduce the trade barriers and improve trade relations within the region. In order to see what would be the potential consequence of a FTA between the TC MCs, we conducted a simulation analysis where all tariff rates are reduced to zero. Applied tariff rates are zero for almost all products for trade among Azerbaijan, Kazakhstan and Kyrgyzstan, but trade between Turkey and other TC MCs face major trade barriers. Therefore, simulation exercise cover only the trade between Turkey and other TC MCs.

Figure 4.15 shows the trade creation and trade diversion effect for Azerbaijan, Kazakhstan and Kyrgyzstan if Turkey reduces tariffs to zero for all products. Such a scenario would produce significant trade within the TC region. For

Azerbaijan, it would create more than USD 13 million export and more than USD 14 million additional export diverted from other countries. In total, Azerbaijan would be in a position to export more than USD 27 million to Turkey, mainly aluminium products, plastic products and organic chemicals. Highest trade effect would be observed for Kazakhstan. Zero tariffs with Turkey would bring more than USD 41 million new exports and an additional USD 46 million worth of exports diverted from other countries. The most critical impact would be observed in the exports of cereals that would be source of an additional USD 61 million export to Turkey. Since existing tariff rate for cereals from Kazakhstan is very high (43.3%), such a large impact would be not surprising. Although a small economy, Kyrgyzstan could also benefit from the elimination of tariffs. It could export around USD 4 million more to Turkey due to such concessions, particularly in vegetables and fruits.

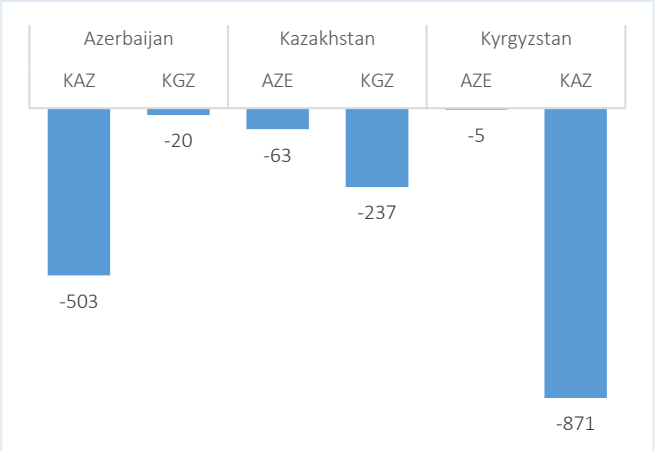
Figure 4.19: Total Impact of Free Trade between Other TC MCs and Turkey (Million USD)



Source: SESRIC staff calculations based on World Bank WITS SMART Module 2015 data for Azerbaijan and 2018 data for Kazakhstan and Kyrgyzstan

In total, there would be around USD 55 million additional import by Turkey if tariffs would be eliminated. Most of this new trade would be generated in cereals and aluminium products (Figure 4.16). However, there are significant tariff revenues gained by countries. Elimination of tariffs would also indicate loss of these revenues. As shown in Figure 4.17, it would cause more than USD 51 million loss of revenue due to cereal imports and almost USD 30 million loss due to imports of other products. These losses are not only due to additional trade created due to tariff reductions, but also abandoning of revenue collection from already imported goods.

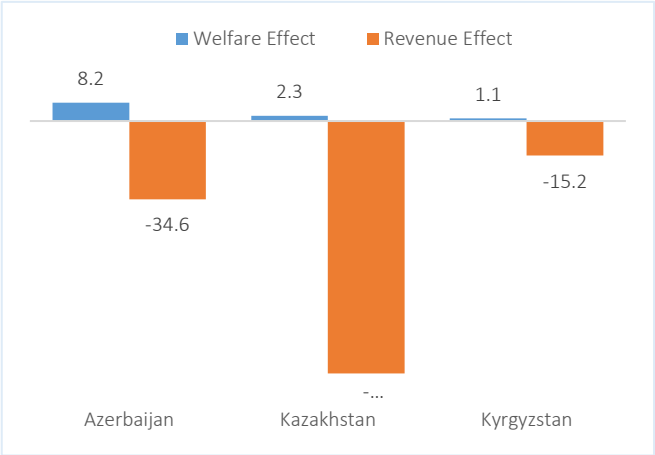
Figure 4.20: Trade Diversion Effect of Free Trade between Other TC MCs and Turkey (Thousand USD)



Source: SESRIC staff calculations based on World Bank WITS SMART Module 2015 data for Azerbaijan and 2018 data for Kazakhstan and Kyrgyzstan

However, loss of revenues does not imply a welfare loss for Turkey. Since consumers will be

Figure 4.21: Welfare and Revenue Impact of Free Trade between Other TC MCs and Turkey (Million USD)



Source: SESRIC staff calculations based on World Bank WITS SMART Module 2015 data for Azerbaijan and 2018 data for Kazakhstan and Kyrgyzstan

able to obtain the imported products at a lower price, they will be positively affected from reduced tariff rates. Overall welfare impact will be positive for Turkey, occurring mainly from cereals import, reaching over USD 13 million (Figure 4.18).

In addition to elimination of tariffs by Turkey, other TC MCs could also eliminate tariffs for imports from Turkey. This would also create important gains for Turkish importers and consumers in other member countries. This would create an opportunity for Turkey to export almost USD 300 million more to other TC MCs, but mostly to Azerbaijan, which would account for USD 180 million additional import from Turkey (Figure 4.19). USD 177 million exports would be newly created, while USD 116 million would be diverted from other markets.

The diversion could take place not only from non-TC MCs, but also from the region as well. Elimination of tariffs for Turkish exporters in Azerbaijan would encourage them to export Azerbaijan instead of Kazakhstan, Kyrgyzstan or other countries. As shown in Figure 4.20, this effect is not quite negligible. Elimination of tariffs by Azerbaijan for Turkish exporters would divert more than USD 0.5 million from Kazakhstan to Azerbaijan and USD 20 thousands from Kyrgyzstan. Elimination of tariffs by Kazakhstan would divert USD 63 thousands from Azerbaijan and USD 237 thousands from Kyrgyzstan to Kazakhstan. Finally, elimination of tariffs by Kyrgyzstan would cause trade diversion from Azerbaijan around USD 5 thousands and USD 871 thousands from Kazakhstan, which is the largest effect of trade diversion.

As in the case of tariff elimination by Turkey, there are also welfare and revenue impacts for other TC MCs if they eliminate tariff for Turkey. Welfare effect is highest in Azerbaijan (USD 8.2 million), followed by Kazakhstan and Kyrgyzstan (Figure 4.21). The revenue effect is largest in Kazakhstan with USD 111.6 million, followed by Azerbaijan (USD 34.6 million) and Kyrgyzstan (USD 15.2 million).

PART III: Investment Patterns among Turkic Council Member Countries

This Part includes the following chapters:

5 Current Trends in Investment

After a short introduction on the importance of investment for growth and development, this chapter discusses the current trends in investment in Turkic Council Member Countries (TC MCs) by looking at FDI flows and stocks datasets, bilateral FDI datasets as well as sectoral FDI datasets. In this way, the chapter aims to reveal the current state of investment in TC MCs and identify trends on investment within the region. The chapter also looks into sectoral FDI datasets to reveal the level of concentration of multinational companies in TC MCs that would help understand factors that lead them to invest more into those sectors. This analysis would also help to shape the policy responses on how to attract more investors, particularly to strategic sectors, that would generate higher economic growth and contribute more to the development of TC MCs as a group.

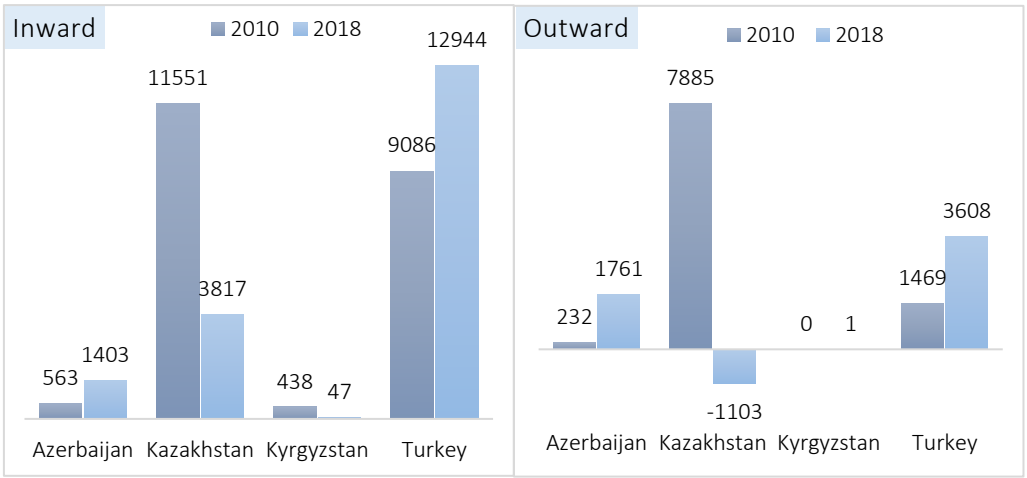
5.1 Importance of Investment for Growth and Development

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

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

In some cases, FDI crowds out local investment because local firms cannot compete with foreign firms due to limitations in size, financing and marketing power. In addition, expatriation of profits by foreign investors may lead to stagnant growth in the host country and transfers demand to the international market rather than the domestic market (Reis, 2002). The quality of FDI is crucial for inducing growth in the economy. Alfaro and Charlton (2007) emphasize the critical role of sectorial composition of FDI inflows on the potential spillover advantages derived from FDI, as those advantages differ markedly across primary, manufacturing and services sectors. For example, FDI in the extractive sector may have limited beneficial spillovers for growth as it often involves mega projects that rarely employ domestically-produced intermediate goods or labour (Lim, 2001). The policy implication for TC MCs is that the policies are needed to direct FDI inflows

Figure 5.1: FDI Inward and Outward Flows, Millions of Dollars



Source: WIR 2019, UNCTAD

to the productive sectors of the economy and the emphasis should be on both on the quality and quantity of FDI. Finally, host economies need to possess the necessary absorptive capacities in terms of institutional quality in order to benefit from expected positive impacts such as, economic development and financial development (Hermes and Antras, 2003; Lensink, 2004; Makki and Somwaru, 2004).

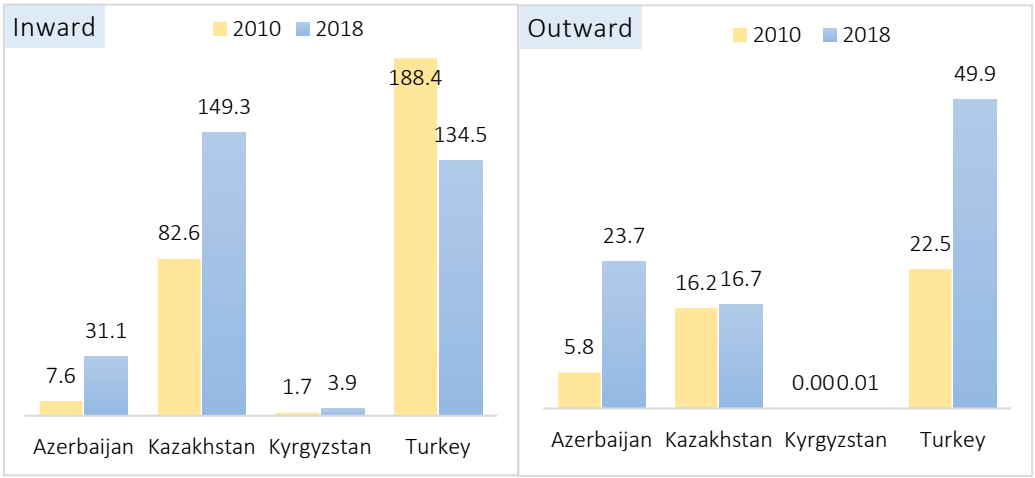
5.2 State of Investment in TC MCs

As the size of TC MCs economies vary, there is limited similarity in terms of the volume of FDI directed to them. Nevertheless, given their size of population, geography and economic potentials, FDI inflows to TC MCs generally remained sub-potential (Figure 5.1). The total USD value of FDI inflows to TC MCs went down from USD 21.6 billion in 2010 to USD 18.2 billion in 2018. A similar picture was seen in the case of FDI outward flows that went down from USD 9.6 billion in 2015 to USD 4.3 billion in 2018. Turkey attracted the highest amount of FDI inward flows (USD 12.9 billion) in 2018 followed by Kazakhstan (USD 3.8 billion). In terms of FDI outward flows, investors originating from Turkey invested USD 3.6 billion and followed by Azerbaijan with an amount of USD 1.7 billion in the same year.

Figure 5.2 presents the FDI stock figures of TC MCs over the period 2010-2018. Turkey accumulated the highest level of FDI stocks outward (USD 50.0 billion) in 2018 among TC MCs. It was followed by Azerbaijan (USD 23.7 billion). Kazakhstan hosted USD 149.3 billion FDI inward stocks in 2018 and was followed by Turkey (USD 134.5 billion) in 2018.

In 2018, four TC MCs altogether attracted 1.4% of the total world FDI inflows and hosted 0.99% of the world FDI inward stocks. In 1995, the share of TC MCs in the world's FDI inward stocks was 0.51 per cent. Therefore, it can be claimed that over the long-run, between 1995 and 2018, there is some improvement in TC MCs in terms of openness to investment that resulted in a higher share (from 0.51% to 0.99%) in the world total FDI inward stocks.

Figure 5.2: FDI Inward and Outward Stocks, Billions of Dollars

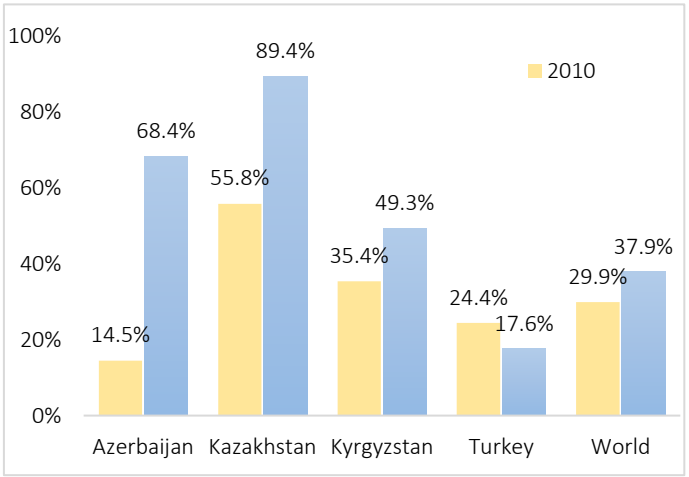


Source: WIR 2019, UNCTAD

Another way of looking into investment performance of countries is to assess FDI figures as a percentage of Gross Domestic Product (GDP) and Gross Fixed Capital Formation (GFCF). These percentages are important in understanding the overall importance of FDI in the national economies and assessing the investment environment. In this regard, Figure 5.3 reveals that the relative importance of FDI instocks in GDP increased in Azerbaijan, Kazakhstan, and Kyrgyzstan over the period 2010-2018. Both in 2010 and 2018 Kazakhstan had the highest share 55.8% and 89.4%, respectively. FDI instocks represented the lowest share in the economy of Azerbaijan among TC MCs in 2010 (14.5%). In 2018, Turkey had the lowest share (17.6%), which could stem from the relatively larger size of GDP compared to other TC MCs.

According to Figure 5.4, FDI inflows made a relatively smaller contribution to the GFCF (investment) in 2018 compared to 2016 in all TC MCs. The most striking fall was recorded in Azerbaijan from 47.5% in 2016 to 11.9% in 2018. Kyrgyzstan also witnessed a remarkable reduction where the share went down from 29.3% to 2.1% in the same period. In particular, the high volatility in such figures may affect national economic growth trajectories and has the potential to change perceptions towards foreign

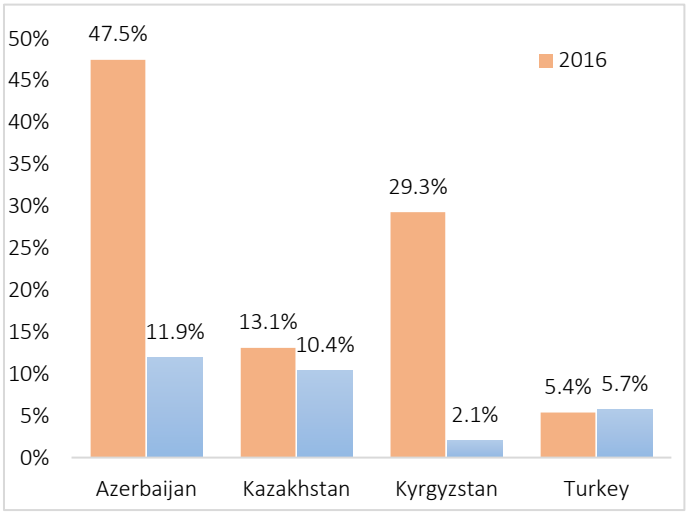
Figure 5.3: FDI instocks as % Gross Domestic Product



Source: WIR 2019, UNCTAD

investors. In this regard, policies need to be developed to ensure that FDI makes smooth, sustainable and foreseeable contribution to the gross fixed capital formation in TC MCs.

Figure 5.4: FDI inflows as % Gross Fixed Capital Formation

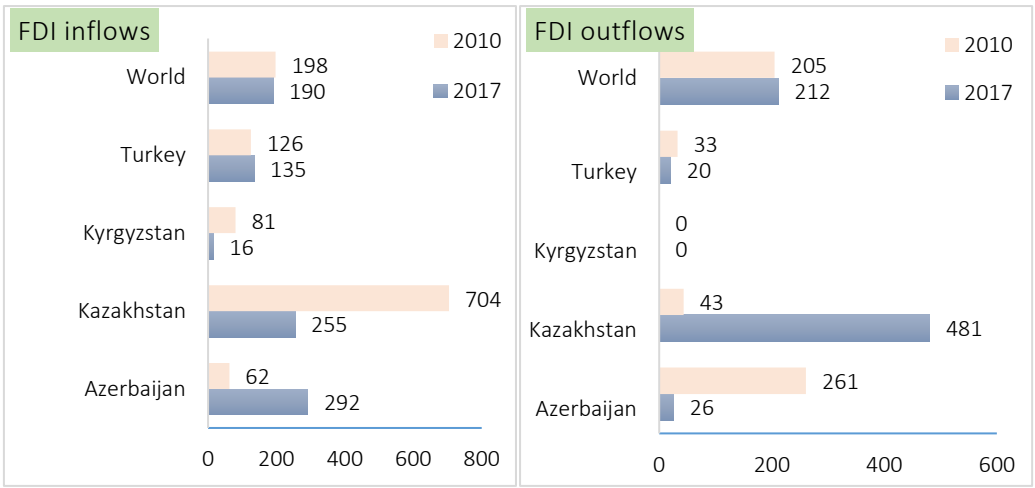


Source: WIR 2019, UNCTAD

On the other hand, a very high level of FDI instocks as a percentage of GDP comes with some certain risks especially in the context of developing countries and TC MCs. For instance, in the case of any economic and political shock, foreign investors may want to relocate their investments to another country. If the total share of foreign investors in an economy exceeds a certain threshold, such a relocation decision may harshly hit the host country economy when backward and forward linkages of foreign investors are counted. In this regard, while economic policies should focus on attracting more FDI in TC MCs, domestic investment and entrepreneurial environment should be strengthened to reduce such potential risks.

A final alternative way of assessing the relative importance of FDI in a country or a group of countries is to measure FDI in per capita terms in order to scale down the volume of FDI with the size of population. In this way, it is relatively easier to make cross-country comparisons. According

Figure 5.5 Per capita FDI inward flows and outward flows, Current USD



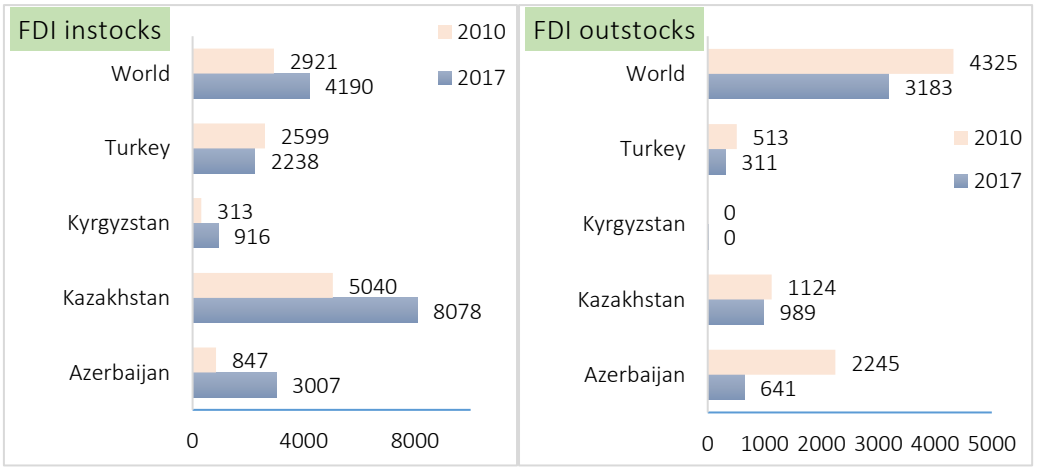
Source: WIR 2018, UNCTAD

to Figure 5.5, Kazakhstan (USD 255) and Azerbaijan (USD 292) attracted FDI inflows more than the world average of USD 190 in 2017. Turkey (USD 135) and Kyrgyzstan (USD 16) stayed below the world average in the same year. In terms of per capita FDI outflows, the performance of TC MCs except Kazakhstan (USD 481) was worse compared to the level of per capita FDI inflows. Azerbaijan (USD 26), Turkey (USD 20) and Kyrgyzstan (USD 0) invested abroad less than the world average of USD 212 in 2017 in per capita terms.

In a similar vein, Figure 5.6 depicts the performance of TC MCs in terms of per capita FDI inward and outward stocks. All TC MCs except Turkey recorded a progress in terms of per capita inward stocks over the period 2010-2017. As of 2017, Kazakhstan (USD 8,078) and Azerbaijan (USD 3,007) hosted the highest amount of FDI inward stocks in per capita terms among TC MCs. With this performance, Kazakhstan (USD 8,078) even exceeded the average of the world (4,190) in 2017. Turkey (USD 2,238) and Kyrgyzstan (USD 916) stayed below the world average of USD 4,190 in the same year. It is important to mention that over the period 2010-2017 Azerbaijan achieved to increase its per capita FDI inward stocks 3.5 times. In this period, Kyrgyzstan also made a commendable effort by increasing the same figure by 2.9 times. In terms of per capita FDI outward stocks, Kazakhstan was the number one TC MC with a value of USD 989 in 2017 and followed by Azerbaijan (USD 641), Turkey (USD 311) and Kyrgyzstan (USD 0) in the same year. These figures reveal that when FDI flows and stocks are measured in per capita terms, the performance of TC MCs does not resemble a high level of similarity. There are some TC MCs that outperformed the world average such as Azerbaijan and Kazakhstan in terms of per capita FDI inflows.

The volume of FDI flows and stocks are useful measures to understand the level of interest of foreign investors into a particular economy. Nevertheless, looking at greendfield investment figures may provide additional insights as they are usually recognized as a more beneficial entry form of investment in which the parent firm constructs its own subsidiary company in a foreign

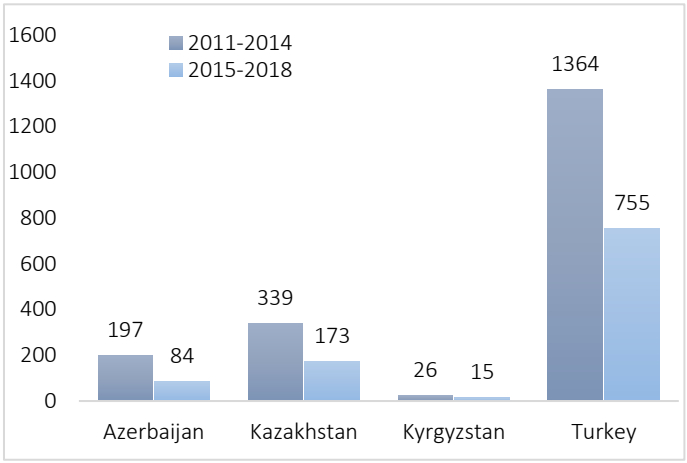
Figure 5.6: Per capita FDI inward stocks and outward stocks, Current USD



Source: WIR 2018, UNCTAD

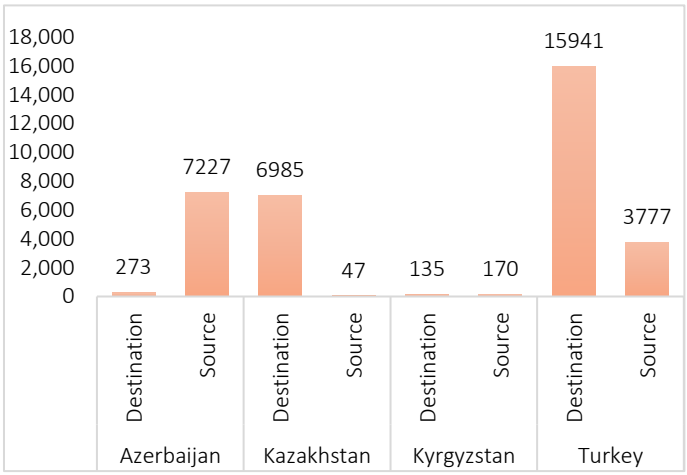
country. It implies an expansion of the existing capital stock in an economy and tend to increase productivity thanks to technology transfer (European Commission, 2017; Harms and Meon, 2014). In this regard, Figure 5.7 and 5.8 report the number and value of greenfield FDI projects in TC MCs. According to Figure 5.7, The total number of announced greenfield FDI projects was the highest in Turkey over the period 2011-2018. In total, 2,119 projects were reported by Turkey and it was followed by Kazakhstan with a number of 512 recorded projects in this period. A closer look into the value of the announced Greenfield Investment Project in 2018 would give a better idea whether TC MCs emerge as a destination or source country for greenfield investors. According to Figure 5.8, Turkey and Kazakhstan achieved to attract more greenfield investors as destinations among TC MCs. On the contrary, Azerbaijan and Kyrgyzstan were identified as two countries where they carried out greenfield investment projects more in other countries compared to greenfield investment projects that they attracted in 2018. In other words, they were net investors rather than investees in terms of the Value of Announced Greenfield Investment Project in 2018. The value of announced greenfield investment project originated from Azerbaijan amounted to USD 7,227 million and followed by Turkey USD 3,777 million in 2018. If these investments could be directed into the Turkic Council region through ensuring a sound cooperation framework, a higher economic growth could be achieved in the region. One of the effective ways to attract and retain greenfield FDI projects is to have Special Economic Zones (SEZ) in which host countries

Figure 5.7: Total Number of Announced Greenfield FDI Projects, by destination



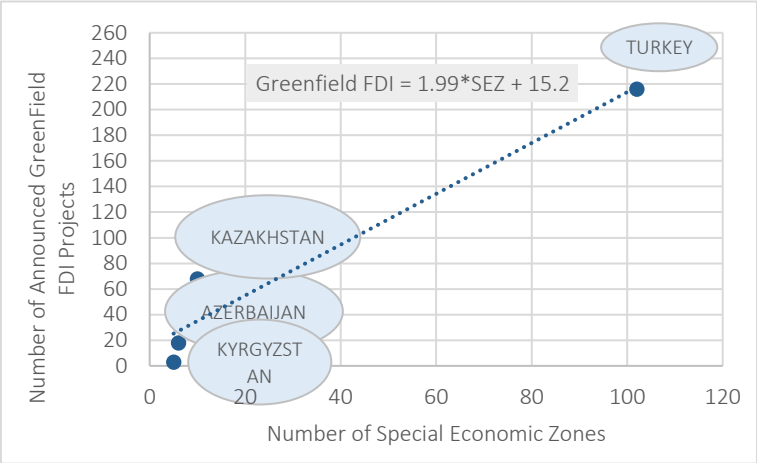
Source: WIR 2019, UNCTAD

Figure 5.8: Value of Announced Greenfield Investment Project in 2018, Millions of dollars



Source: WIR 2019, UNCTAD

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



Source: SESRIC Staff Calculation based on WIR 2019, UNCTAD

provide an attractive investment infrastructure with certain advantages (e.g. tax incentives, low transport and energy costs) for investors (UNCTAD, 2019). Figure 5.9 points out that this holds true in the case of TC MCs. Countries with more SEZ tend to report more greenfield FDI projects in 2018. For instance, Turkey with 102 SEZ announced 216 greenfield FDI projects in 2018. The Figure 5.9 reveals that, all else equal, each additional SEZ associates with about two new greenfield FDI projects in TC MCs on average. In this respect, one way of maximising the number of greenfield FDI projects in TC MCs is to develop new SEZ and rehabilitate the existing ones for providing more effective investment infrastructure especially for new investors.

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

5.3 Investment among Turkic Council Countries

As in other dimensions of the economic integration among TC MCs (e.g. trade and tourism), intra-TC FDI trends can be a good indicator to assess the level of economic integration among TC MCs. Intra-TC FDI figures reflect directed investment from one source Turkic Council member country to another host Turkic Council member country. A higher volume of intra-TC FDI implies the existence of stronger economic ties among them.

Table 5.1 presents FDI estimates by ultimate investor share in inward FDI stocks in 2017. According to the Table, Turkey emerges as top investor Turkic Council member country with shares in FDI inward stocks in Azerbaijan (19.8%), Kazakhstan (0.5%), and Kyrgyzstan (3.7%). The share of investment originating from Kazakhstan reached 4.4% in Kyrgyzstan and only represented 0.1% in FDI inward stocks of Turkey. Investors from Kazakhstan obtained a share of

Table 5.1: FDI estimates by ultimate investor, share in inward FDI stock, 2017

Recipient					
		Azerbaijan	**Kazakhstan**	**Kyrgyzstan**	**Turkey**
Investor	**Azerbaijan**	N/A	0.0	N/A	5.8
	Kazakhstan	0.3	0.1	4.4	0.1
	Kyrgyzstan	N/A	N/A	N/A	N/A
	Turkey	19.8	0.5	3.7	0.1

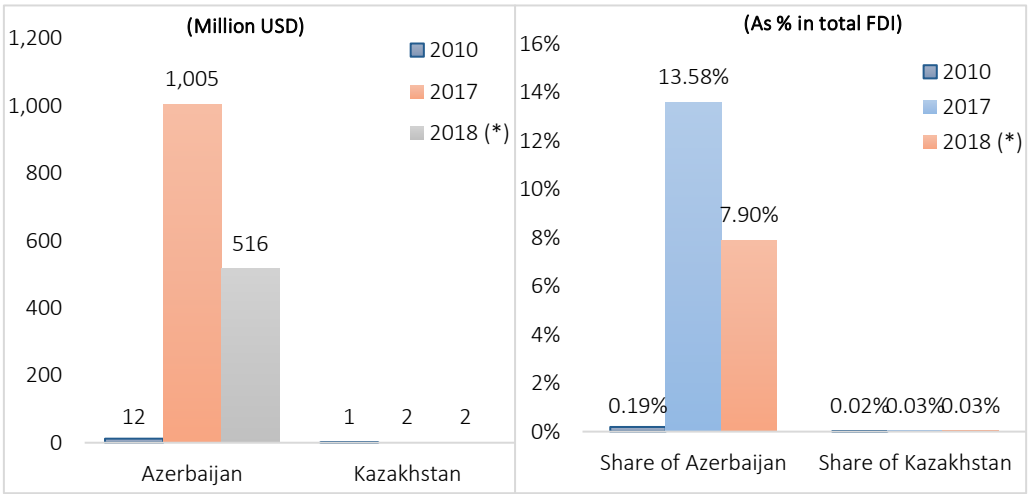
Source: Annex Table 22, WIR 2019, UNCTAD. Na stands for not available.

0.3% in FDI inward stocks of Azerbaijan. On the other hand, FDI originating from Azerbaijan represented a share of 5.8% in FDI inward stocks of Turkey.

Some individual country-level data may provide additional insights on investment patterns among TC MCs. According to Figure 5.10, Data obtained from the Central Bank of the Republic of Turkey revealed that FDI inflows from Azerbaijan was significant both in 2017 (USD 1,005 million) and 2018 (USD 516 million). With these figures, Azerbaijan represented a share of 13.6% and 7.9% in total FDI inflows of Turkey in 2017 and 2018, respectively. FDI from Kazakhstan was only around USD 2 million in 2017 and 2018. Therefore, the share of Kazakhstan was measured around 0.03% in total FDI inflows of Turkey in 2017 and 2018.

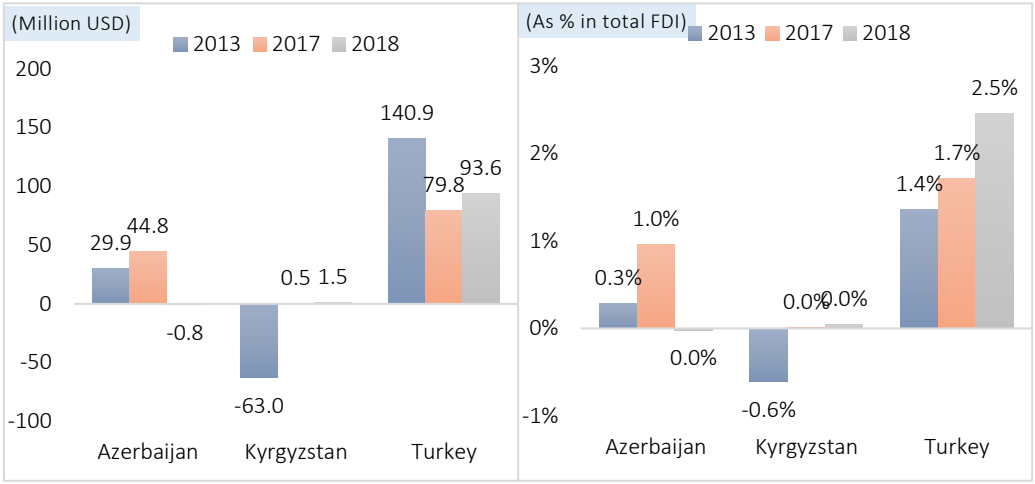
According to Figure 5.11, net FDI inflows in Kazakhstan from TC MCs followed a volatile trend. Net investment originating from Azerbaijan was positive in 2013 (USD 29.9 million) and 2017 (USD 44.8 million) that turned out to be negative in 2018 (USD -0.8 million). Investment from Kyrgyzstan was negative in 2013 (USD 63 million). Nevertheless, both in 2017 and 2018 it was recorded as positive. Turkish net investment in Kazakhstan was also positive in 2013, 2017 and

Figure 5.10: FDI inflows in Turkey from Turkic Council Member Countries



*Source: Central Bank of Turkey. Notes: *2018 provisional data. Azerbaijan and Kyrgyzstan were not reported due to missing data.*

Figure 5.11: Net FDI inflows in Kazakhstan from Turkic Council Member Countries



Source: National Bank of Kazakhstan.

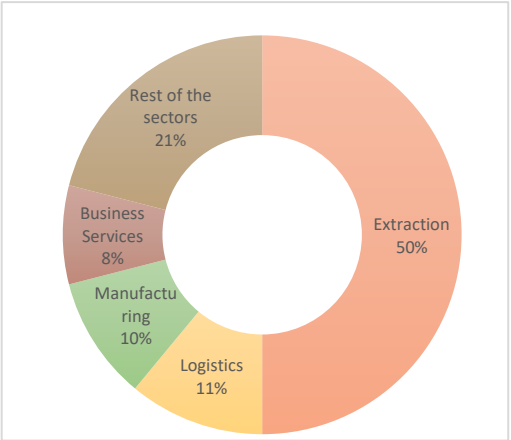
2018, and was measured at USD 93.6 million in 2018. The share of Turkey grew gradually and represented 2.5% in 2018 in total net FDI inflows of Kazakhstan.

Finally, Figure 5.12 presents top five investor countries according to the origin of foreign investors in non-oil sector of Azerbaijan over the period 2000-2017. Turkey was the leading investor country into the non-oil sector in Azerbaijan that invested about USD 2,588 million in total and followed by the UK with an amount of USD 1,649 million. The Netherlands, the USA, and Russia were three remaining top investor countries in Azerbaijan in this period.

Box 5.1: Investment Opportunity in Azerbaijan

Over the period 2003-2017, almost half of all new FDI projects were realized in the extraction followed by logistics with a share of 11%. It was followed by manufacturing (10%) and business services (8%). Figure 5.B1 reveals that in Azerbaijan the oil industry is still strong but other sectors have become attractive for foreign investors like logistics and manufacturing. As a result, it is expected that more foreign investors would choose to invest in non-oil industry in upcoming years. Such potential investment opportunities would be filled by TC MCs, if appropriately planned and promoted.

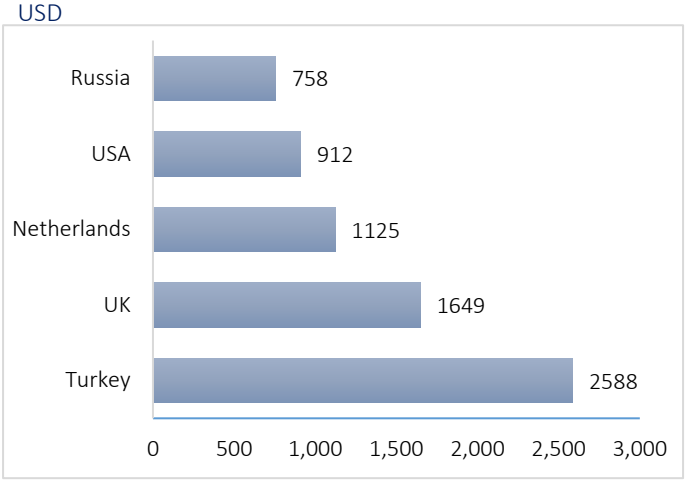
Figure 5.B1: Sectoral Distribution of New FDI Projects in Azerbaijan, 2003-2017



Source: OECD, 2019

According to bilateral and regional datasets on TC MCs, the level of economic integration in terms of FDI reveal the existence of significant untapped potential that needs to be addressed through designing and implementing effective policies both at the national level as well as at the regional level. TC MCs not only attract lower amount FDI flows given their economic potentials but also they do not usually seem to emerge as main investor countries in each other. Nevertheless, this picture could change, if the level of economic cooperation at regional level is elevated. The policy options to unleash the potential investment among TC MCs would include establishment of joint investment areas and special economic and investment zones, elimination of investment and trade barriers, design of joint arbitration mechanism to address investment disputes, and development of a regional investment treaty at the level of TC MCs.

Figure 5.12: Countries of Origin of Foreign Investors in Azerbaijan in Non-Oil Sector (2000-2017), Top Five, Million USD

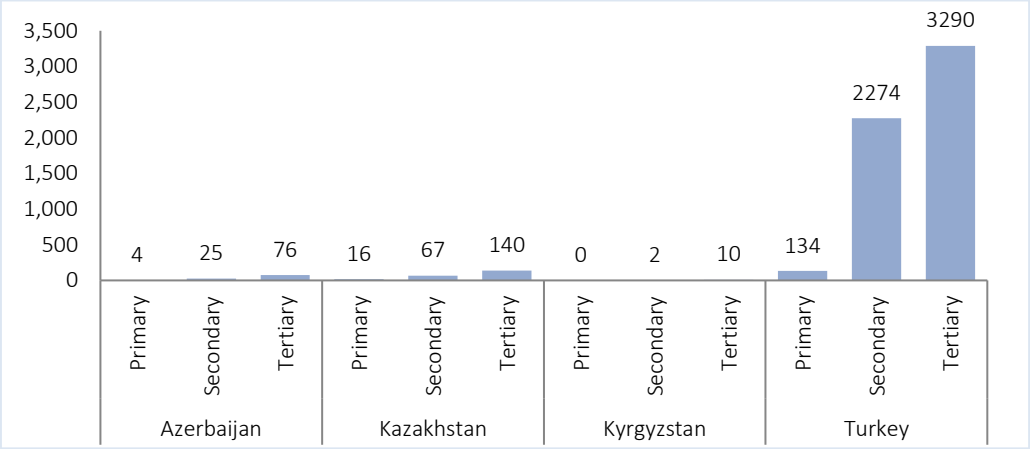


Source: State Statistical Committee of Azerbaijan

5.4 Investment Patterns at Sectoral Level

This section analyses investment patterns in TC MCs at sectoral level by benefiting from available international datasets. The sectoral analysis would be of important to identify competitiveness

Figure 5.13: Sectoral Distribution of Foreign Affiliates in Turkic Council Countries (Number of Foreign Affiliates, 2017)



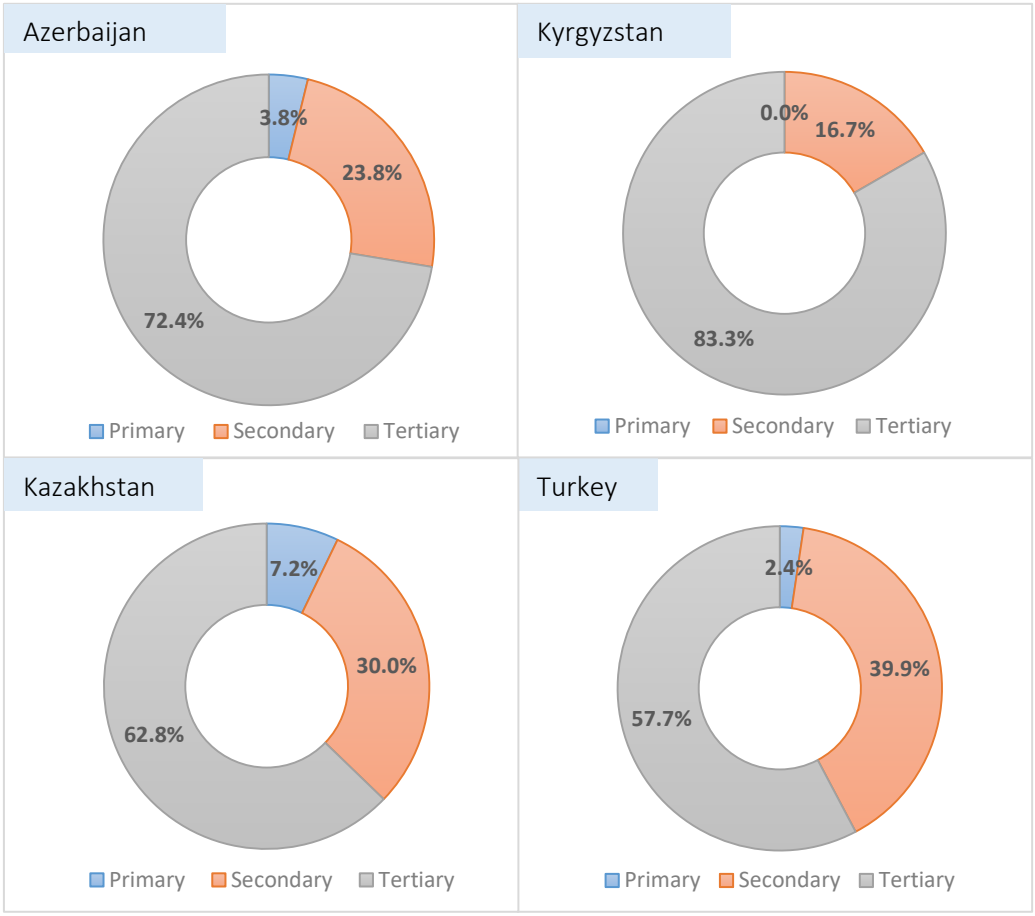
Source: Investment Map, IntraCen 2019. Note: SESRIC Staff Calculation based on Number of Foreign Affiliates.

and attractiveness of various sectors in TC MCs for investment and would help to shape the policy solutions at TC MCs for prioritization and identification investment projects.

According to Figure 5.13, the highest number of foreign affiliates in TC MCs is found to be in the tertiary sector as of 2017. Turkey hosted 3,290 foreign affiliates in the tertiary sector and was followed by Kazakhstan with a number of 140 foreign affiliates in that sector. In the secondary sector, all TC MCs hosted a total of 2,368 foreign affiliates where 2,274 of them were located in Turkey. The number of foreign affiliates in TC MCs was 154 in the primary sector. Again, Turkey was the leading country in terms of total number of foreign affiliates in that sector. Kazakhstan had 16 foreign affiliates in 2017 in the primary sector.

Figure 5.14 reveals the sectoral concentration of foreign affiliates in TC MCs in 2017. In Azerbaijan, 72.4% of foreign affiliates were registered in the tertiary sector which was followed by the secondary sector with a share of 23.8%. In Kyrgyzstan, the share of the tertiary sector exceeded 80% threshold and was measured at 83.3%. And the rest of the foreign affiliates were

Figure 5.14: Sectoral Concentration of Foreign Investors in Turkic Council Countries, 2017



Source: Investment Map, IntraCen 2019. Note: SESRIC Staff Calculation based on Number of Foreign Affiliates.

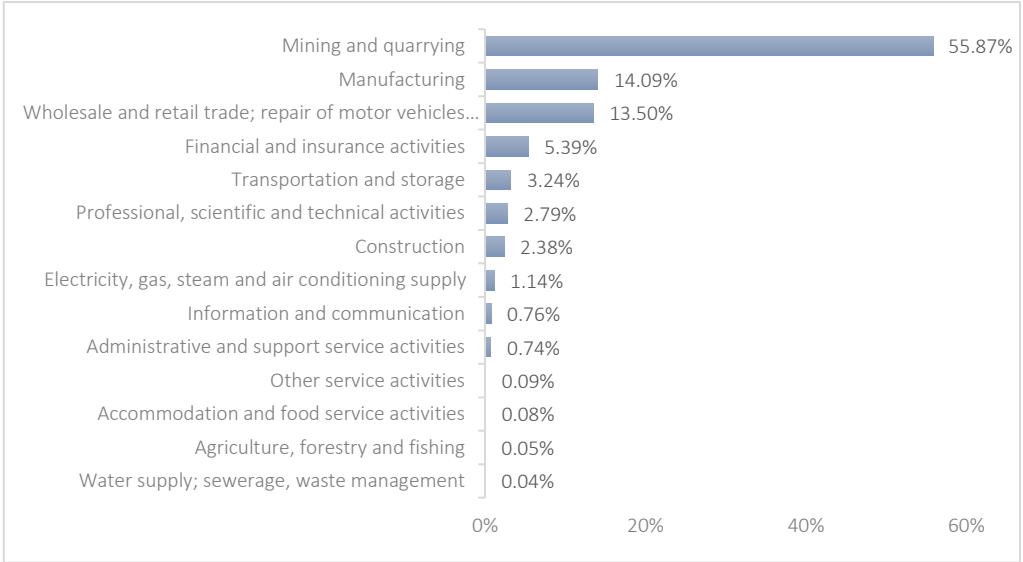
located in the secondary sector (16.7%). In Kazakhstan, the primary sector obtained the highest share (7.2%) among TC MCs. About 30% of foreign affiliates operated in the secondary sector and the remaining 62.8% of them were located in the tertiary sector. In Turkey, the foreign affiliates in the tertiary sector represented the lowest share (57.7%) among TC MCs whereas the secondary sector had the highest share (39.9%). Finally, foreign affiliates registered in the primary sector represented a share of 2.4% in Turkey.

Overall, the most attractive sector for foreign affiliates in TC MCs was identified as the tertiary sector that includes sub-sectors such as education, finance, construction, transport and hotels. Nevertheless, there are some countries like Turkey where a more balanced distribution was observed thanks to the existence of an attractive secondary sector. It is also revealed that Kazakhstan has a relatively strong and competitive primary sector that its share in all foreign affiliates exceeded 7% that was the highest value among TC MCs in 2017.

Box 5.2: Investment Opportunity in Kazakhstan

As of 2018, based on gross FDI inflows, in Kazakhstan 55.9% of foreign investors were operating in the mining and quarrying (Figure 5.B2). About 14.1% of them registered in the manufacturing industry that was followed by the wholesale and retail (13.5%) and financial and insurance activities (5.4%). The figures might reflect high potentials for profit especially for foreign investors in the mining and quarrying in Kazakhstan that investors from other TC MCs could consider in their search and decision making processes. Nevertheless, manufacturing and wholesale and retail sectors seem also to be attractive and sound for investors that TC MCs should take into consideration.

Figure 5.B2: Sectoral Disribution of Foreign Investors Kazakhstan, 2018 (based on gross FDI inflows)



Source: SESRIC Staff Calculation from Kazak National Bank

6 Analysis of Investment Climate and Major Impediments to Investment

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

6.1 Ease of Doing Business

The quantity of investment matters for promoting growth and sustaining development. Nevertheless, the productivity gains that result from product and process innovation brought about through investments are critical to consider in attracting investments (World Bank, 2004). In this regard, the investment climate consequently needs to provide opportunities and incentives for firms and entrepreneurs to develop, adapt and adopt better ways of doing business as well as to encourage investments. In other words, existing investment climate affects both the quality and quantity of investments. An investment climate conducive for new investments not only triggers economic growth but also helps transition of economic sectors and actors to a higher level of development.

Against this backdrop, the investment climate in TC MCs can be assessed by using the Ease of Doing Business (EDB) Index of the World Bank that provides unique and comparable information that can be used in cross-country comparisons over a given period.

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

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

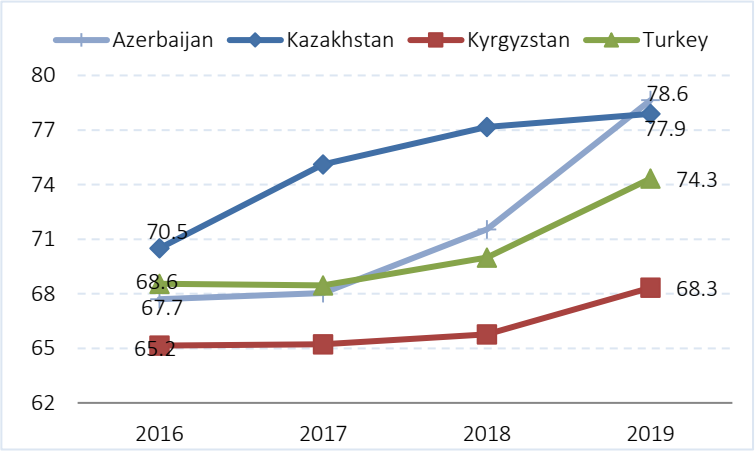
6. Protecting investors – Indices on the extent of disclosure, extent of director liability and ease of shareholder suits;
7. Paying taxes – Number of taxes paid, hours per year spent preparing tax returns and total tax payable as share of gross profit;
8. Trading across borders – Number of documents,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

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

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

Figure 6.1 shows the average value of ease of doing business indicator for TC MCs over the period 2016-2019. The business environment in all TC MCs improved over this period where the average index values climbed up compared their initial values recorded in 2016. Azerbaijan improved its score the most that went up from 67.7 in 2016 to 78.6 in 2019. In terms of the level of the recorded progress between 2016 and 2019, Kazakhstan followed Azerbaijan where its average score increased from 70.5 in 2016 to 77.9 in 2019. Turkey ranked third according to the degree of recorded progress, whose average score peaked at 74.3 in 2019. Finally, Kyrgyzstan also achieved to improve its business climate slightly as its score went up from 65.2 in 2016 to 68.3 in 2019. As of 2019, among TC MCs, Kazakhstan had the most favourable business climate for doing business according to the EDB index scores.

Figure 6.1: Ease of Doing Business Index Scores in Turkic Council Countries (2016-2019)



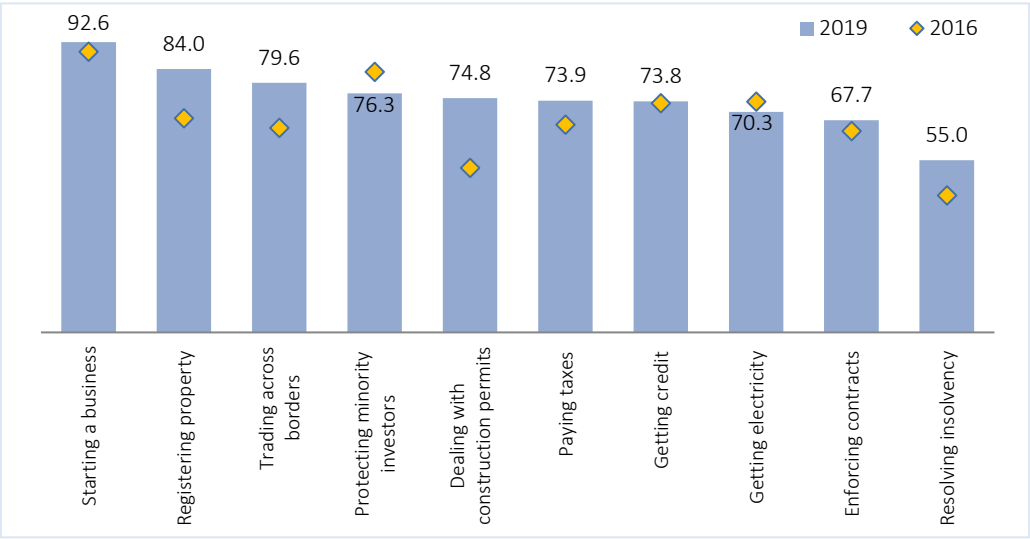
Source: World Bank, Ease of Doing Business Report 2019. Score values: 0 (worst)-100 (best)

Looking at the average sub-index score performances of TC MCs would provide additional insights regarding the obstacles and barriers for doing business in TC MCs. In this regard, Figure 6.2 presents the average performance of TC MCs over the period 2016-2019 in the sub-index scores.

The subindex on resolving insolvency looks at the time, cost and outcome of insolvency proceedings involving domestic entities as well as the strength of the legal framework applicable to judicial liquidation and reorganization proceedings. Resolving insolvency is the dimension with the lowest average score obtained by TC MCs both in 2016 and 2019. Nevertheless, there is a considerable progress in TC MCs that their average score increased from 43.7 in 2016 to 55 in 2019. The subindex on enforcing contracts measures the time and cost for resolving a commercial dispute through a local first-instance court and the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote quality and efficiency in the court system. Overall, the efficiency of the judicial system in resolving a commercial dispute is also highly critical in improving the business and investment climate. The area of enforcing contracts seem to emerge another problematic area in doing business in TC MCs that the average score could not exceed 70 both in 2016 and 2019.

On the other side of the spectrum, TC MCs, on average, have a very much favourable environment in starting a business. On average, there are not many time and money consuming procedures to start a business. In this dimension, a further improvement was recorded between 2016 and 2019 that the average score reached 92.6. In TC MCs, on average, businesses could register their properties very easily that does not seem to be a major area of concern in 2019 given the average score of 84. TC MCs, on average, recorded a remarkable progress in this dimension that made the business life of companies relatively easier between 2016 and 2019.

Figure 6.2: The Average Score of Turkic Council Countries in Sub-Indicators of the Ease of Doing Business Index (2016 versus 2019)



Source: World Bank, Ease of Doing Business Report 2019. Score values: 0 (worst)-100 (best)

Table 6.1: Completed Reforms to Ease Doing Business in 2017-2018

REFORM AREAS	Azerbaijan	Kazakhstan	Kyrgyzstan	Turkey
Starting a business		Yes		Yes
Dealing with construction permits	Yes			Yes
Getting electricity	Yes			
Registering property	Yes			
Getting credit	Yes			Yes
Protecting minority investors	Yes			
Paying taxes	Yes			Yes
Trading across borders	Yes	Yes	Yes	Yes
Enforcing contracts		Yes	Yes	Yes
Resolving insolvency	Yes		Yes	Yes

Source: Adapted from Doing Business Report 2019.

TC MCs, on average, made good strides to improve their business and investment climate in recent years. This progress is reflected in their average scores in the ease of doing business index scores and its subindex scores. These improvements do not fall from the sky and stem from well-planned and implemented reforms to overcome barriers that constitute impediment for doing business in TC MCs. In this regard, Table 6.1 summarizes the completed reforms in TC MCs in 2017-2018 in all ten areas of the ease of doing business index. Azerbaijan completed reforms in eight areas and was followed by Turkey that made reforms in seven areas. Both Kazakhstan and Kyrgyzstan exerted efforts to complete reforms in three areas over this period. The details of these reforms are reported in Annex Table 6.A1.

Nevertheless, as the competition among developing countries increase, TC MCs should not stop making reforms in such areas of concern and need to accelerate the pace of reform processes. Moreover, establishing an effective cooperation framework among TC MCs on these reform areas not only would lead to effective exchange of expertise, knowledge and best-practices but also has the potential to drive Turkic Council Cooperation to greater heights.

6.2 Perceived Constraints to Investment at Firm Level

This sub-section focuses on perceived constraints to investment especially at firm level through analysing a number of selected indicators including Logistics Performance Index (LPI) and World Bank's World Enterprise Survey.

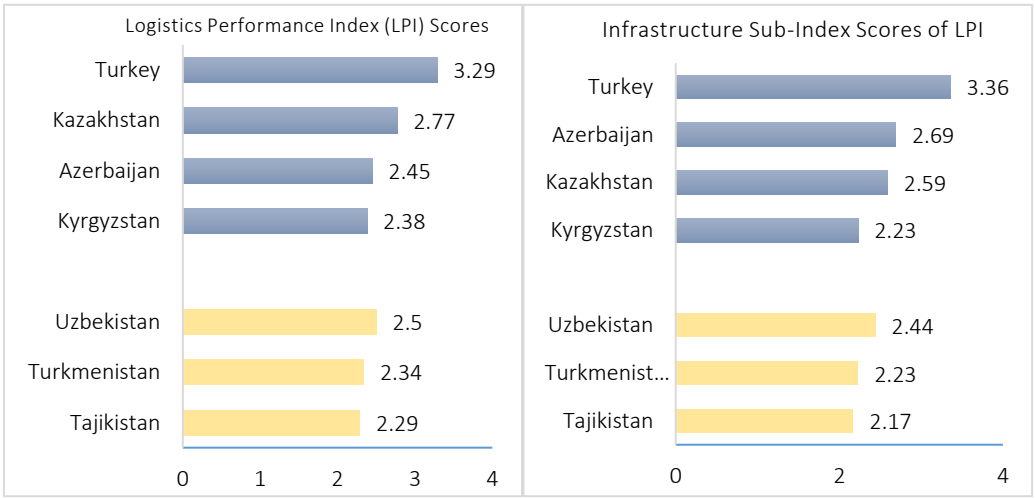
For multinational companies and international investors, connectivity of host countries is of importance to ensure uninterrupted exports and imports of raw, intermediate and final goods and services throughout their operations. Moreover, connectivity networks define their growth potentials not only in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

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

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

The LPI uses standard statistical techniques to aggregate the data into a single indicator that can be used for cross-country comparisons. It takes values between 1 and 5, where a score of 5 shows the highest development level of logistics performance. A country with improved logistics performance tends to have an improved transportation networks and infrastructure. According to the LPI scores reported in Figure 6.3, Turkey obtained highest score (3.29) and was followed by Kazakhstan (2.77) and Azerbaijan (2.45) in 2018. Kyrgyzstan had the lowest LPI score (2.38) among TC MCs in the same year. Countries in the Central Asia obtained some similar scores in the range of 2.5 (Uzbekistan) and 2.29 (Tajikistan). In terms of infrastructure subindex score of the LPI again Turkey was the leading country with a score of 3.36 and was followed by Azerbaijan (2.69).

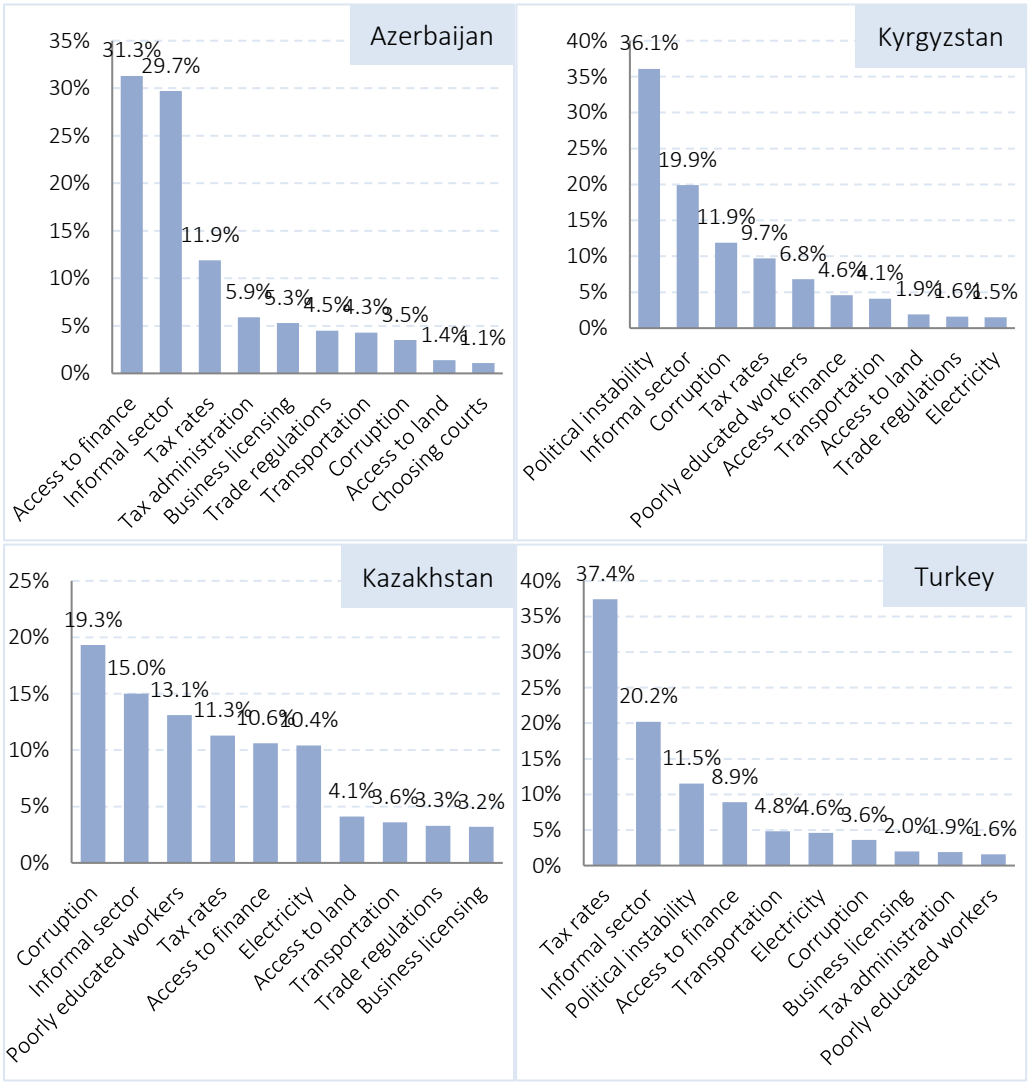
Figure 6.3: Logistics Performance Index (LPI) Scores and Infrastructure Sub-Index Scores in Turkic Council Countries, 2018



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

The LPI scores in Figure 6.3 revealed that TC MCs need to exert efforts to improve their transportation networks with a view to increasing connectivity. In particular, Kazakhstan, Azerbaijan and Kyrgyzstan need to do more in order to narrow down the gap between Turkey in terms of connectivity such as by investing into infrastructure and embarking on cross-border transportation projects. In fact, the Turkic Council regional cooperation platform would be effective in terms of sharing knowledge and expertise among TC MCs in this particular area of concern that is critical for investors.

Figure 6.4: Top Ten Major Obstacles for Firms in the Business Environment in Turkic Council Countries (% Firms Responded to Survey, 2013)

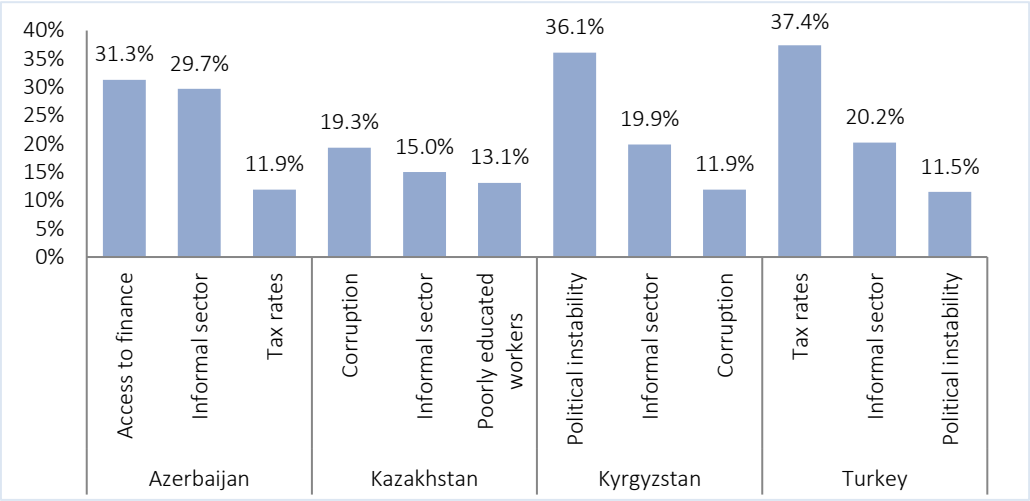


Source: World Bank, Enterprise Survey Note: The survey data of Kazakhstan were reported in 2013 by 600 firms.The survey data of Azerbaijan were reported in 2013 by 390 firms. The survey data of Turkey were reported in 2013 by 1344 firms.The survey data of Kyrgyzstan were reported in 2013 by 270 firms.

Perceived constraints to investment at firm level can be best assessed by using firm level data that reflect the views of companies regarding the barriers and constraints that face in day-to-day operations on investments. In this context, Figure 6.4 reports the World Bank's Enterprise Survey conducted in 2013 in TC MCs. The survey questions aimed at identifying top ten major obstacles for firms in the business environment that ultimately affect their decision to invest. In Azerbaijan access to finance and informal sector emerged as two leading obstacles for firms. About one-third of companies, who responded the survey, reported them as obstacles. In particular, limited access to finance tend to reduce the growth potentials of SMEs and has some negative impact on FDI (Ayyagari et al., 2017). In Kyrgyzstan political instability was chosen by 36.1% of firms, who responded the survey, as an obstacle and about 20% of firms said that informal sector is a major concern in doing business and making investment decisions. In Kazakhstan, corruption (19.3%) and informal sector (15%) seem to be identified by firms as two major obstacles that impede doing business and making investments. Finally, 37.4% of firms responded to survey in Turkey reported that the level of tax rates is a major obstacle. About 20% of firms said that informal sector creates a hurdle for them in the business environment that needs to be addressed. Even though the ranking of ten major obstacles in TC MCs vary, there are some commonalities and some of the concerns seem to be mentioned more than others.

In this context, Figure 6.5 depicts the World Bank's Enterprise Survey results just by focusing on three major obstacles for firms in TC MCs. This way of presenting the survey results would help to identify some common obstacles emerged in TC MCs in doing business and making investments from the view of firms. According to Figure 6.5, informal sector were reported as one of the most important obstacles in all TC MCs. Corruption, tax rates, and political instability were also identified among common and major obstacles in the Turkic Council region. These

Figure 6.5: Top Three Major Obstacles for Firms in the Business Environment in Turkic Council Countries (% Firms Responded to Survey, 2013)



Source: World Bank, Enterprise Survey Note: The survey data of Kazakhstan were reported in 2013 by 600 firms.The survey data of Azerbaijan were reported in 2013 by 390 firms. The survey data of Turkey were reported in 2013 by 1344 firms.The survey data of Kyrgyzstan were reported in 2013 by 270 firms.

findings would give some hints to identify priority reform areas in TC MCs to improve the investment climate at the individual country level. Moreover, as some of these obstacles were reported frequently by many firms operating in TC MCs, some joint efforts can be put forward at the Turkic Council level on how to address them in cooperation and by benefiting from national experiences and success stories of TC MCs in these areas.

6.3 Potential Risks and Uncertainties

Investors would like to benefit from opportunities available all around the globe to maximise their profits. Nevertheless, they do not like risks and uncertainties that could constitute a threat for their investment or limit their manoeuvre area such as by limiting profit transfers or currency exchange. Therefore, they conduct a series of risk evaluations before making any decision to invest.

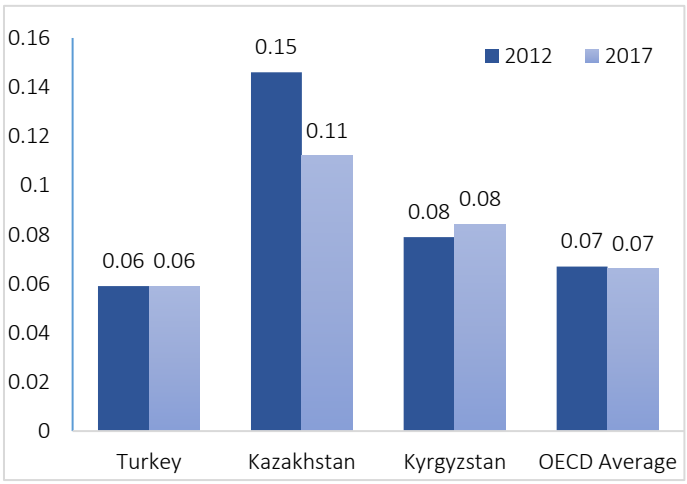
Amongst others, FDI rules and regulations are a critical determinant of a country's attractiveness to foreign investors. In this context, the OECD developed the FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment in 22 economic sectors in countries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

Foreign equity limitations;

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

The FDI Index is not a full measure of a country's investment climate but gives an overall idea regarding the potential risks and uncertainties for foreign investors. A lower index score implies less restrictiveness. In this regard, Figure 6.6 reports the FDI Regulatory Restrictiveness Index scores for Turkey, Kazakhstan and Kyrgyzstan, and compares them with the OECD average over the period 2012-2017. Turkey obtained the lowest score among TC MCs and its score (0.059) was even found to be lower than the OECD average (0.066) in 2017. Between 2012 and 2017, the

Figure 6.6: OECD FDI Regulatory Restrictiveness Index



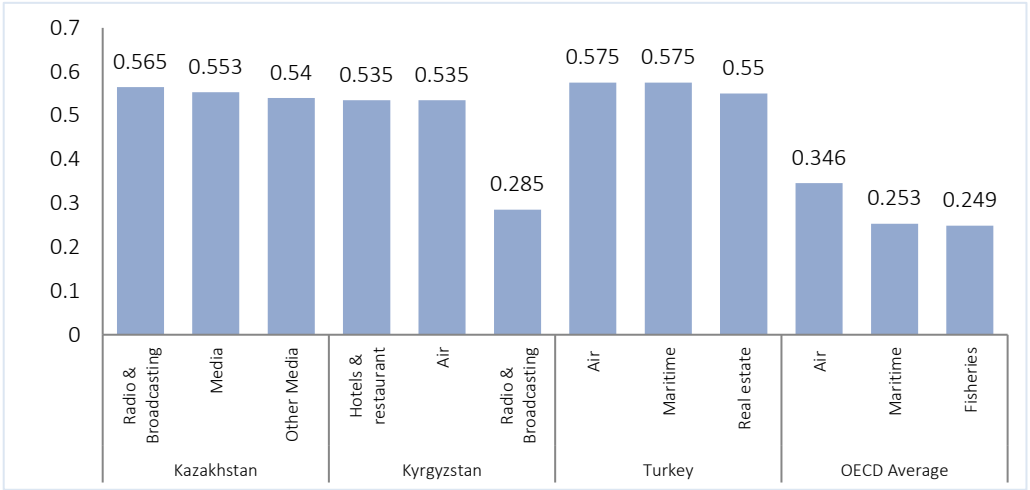
Source: OECD Stat, 2019. Note: The ranking was made according to the total FDI restriveness index scores of the countries. Azerbaijan is excluded due to missing data. A lower score implies less restrictiveness.

score of Turkey did not change. On the other hand, Kazakhstan made a remarkable progress in the same period that its score went down from 0.146 in 2012 to 0.112 reflecting a reduction on restrictions for foreign investors. A slight increase in the level of restrictions on FDI was observed in Kyrgyzstan during this period that its score climbed up from 0.079 in 2012 to 0.084 in 2017. Both the scores of Kazakhstan and Kyrgyzstan stayed well above to the averages of OECD during this period.

Unlike geography, FDI rules and regulations are something over which governments have control. Therefore, it is possible to change and influence with policies. In this regard, the results imply that TC MCs need to intensify their efforts to overcome regulatory barriers to invest in their economies with a view to attracting more FDI from each other and elsewhere. In this picture, the Turkic Council emerges as a potential cooperation platform that member states could work together and share their experiences with each other to overcome such restrictions in the region.

Figure 6.7 displays the top three most restrictive sectors for FDI in TC MCs in 2017. At the sectoral level, in Kazakhstan, radio and broadcasting, media, and other media sectors were found to be with the highest level of regulatory restrictions for foreign investment. In Kyrgyzstan, again sub-categories of the services sector namely hotels and restaurants, air and radio and broadcasting were identified as the sectors with relatively higher regulatory restrictions for foreign investment. In Turkey, top three restrictive sectors for FDI were air, maritime and real estate in 2017. On average, in OECD countries, air, maritime and fisheries emerged as top three restrictive sectors in 2017. Overall, the sectoral analysis revealed some information regarding the state of restrictions on economic sectors in TC MCs that limit FDI inflows into them. This provides some hints to policy makers on which sectors to prioritize in removing specific restrictions and obstacles in TC MCs.

Figure 6.7: Top Three Most Restrictive Sectors for FDI, 2017 (based on total FDI restrictiveness index scores)



Source: OECD Stat, 2019. Note: The ranking was made according to the total FDI restrictiveness index scores of the countries. Azerbaijan is excluded due to missing data. A lower score implies less restrictiveness.

Country Risk Classification of the OECD

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

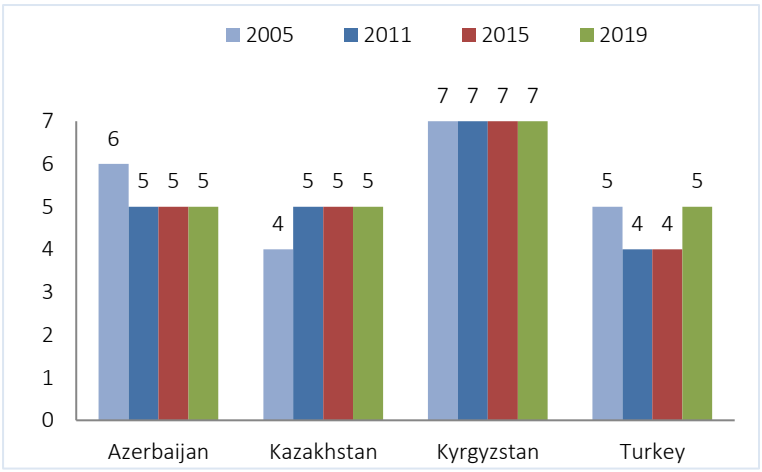
The country risk classification (CRC) indicator was first developed in 1997 by the participants to the Arrangement on Officially Supported Export Credits with a view to setting minimum premium rates for transactions supported by governments according to the Arrangement. The list of country risk classifications is also made public so that any country that is not an OECD Member or a Participant can make use of the indicator. Over the last two decades, it has become an important indicator used by investors, researchers, multilateral institutions as well as public officials to track and monitor the prevailing risks in countries across the globe

The indicator takes values between 0 and 7 through the application of a two-step methodology comprising both quantitative and qualitative assessment. A higher value represents the existence of a higher risk exposure for investors.

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

According to Figure 6.8, TC MCs obtained scores between 4 and 7 over the period 2005-2019. Azerbaijan achieved to decrease its score from 6 in 2005 to 5 in 2011 and it maintained it at the same level as of 2019. The risk score of Kazakhstan went up from 4 in 2005 to 5 in 2011 and stayed at this level as of 2019. The score of Kyrgyzstan stayed unchanged at the level of 7 (highest risk score value). Turkey maintained its score in the range of 4 to 5 during this period and as of 2019 it was identified as 5. Overall, as of 2019, among TC MCs, there is no single

Figure 6.8: OECD Risk Classification of Turkic Council Countries, 2005-2019



Source: OECD Country Risk Classification Dataset, Version: 28/02/2019. Riks score scale: 0 (lowest risk)- 7 (highest risk)

country that has a lower score than 5. Even the score of Kyrgyzstan is very high (7), which is the highest possible risk score. In this picture, TC MCs should work together to reduce their country risk scores to provide a business environment where there is limited risks and uncertainties for investors.

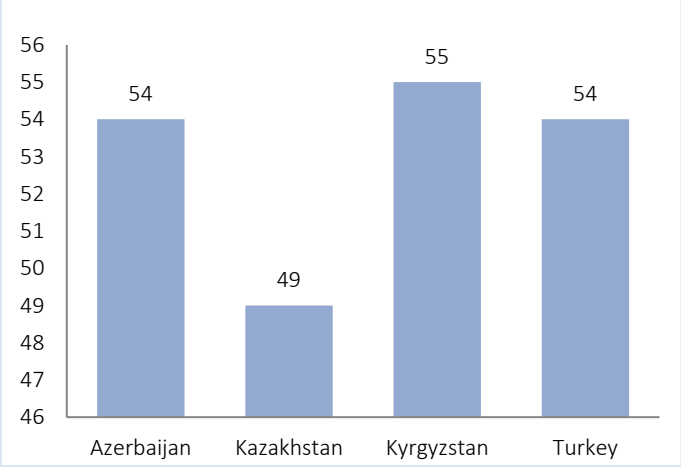
Country Risk Classification of the Economist Intelligence Unit

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

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

A higher score implies the existence of higher risk and the maximum score can be obtained is 100. According to Figure 6.9, Kazakhstan obtained the lowest score (49) among TC MCs in 2018. It was followed by Turkey (54) and Azerbaijan (54). Kyrgyzstan obtained a score of 55 in 2018. Figure 6.10 depicts the distribution of risk scores in TC MCs. In three countries (Azerbaijan, Kazakhstan and Kyrgyzstan), the government effectiveness risk score was found to be the highest in 2018.

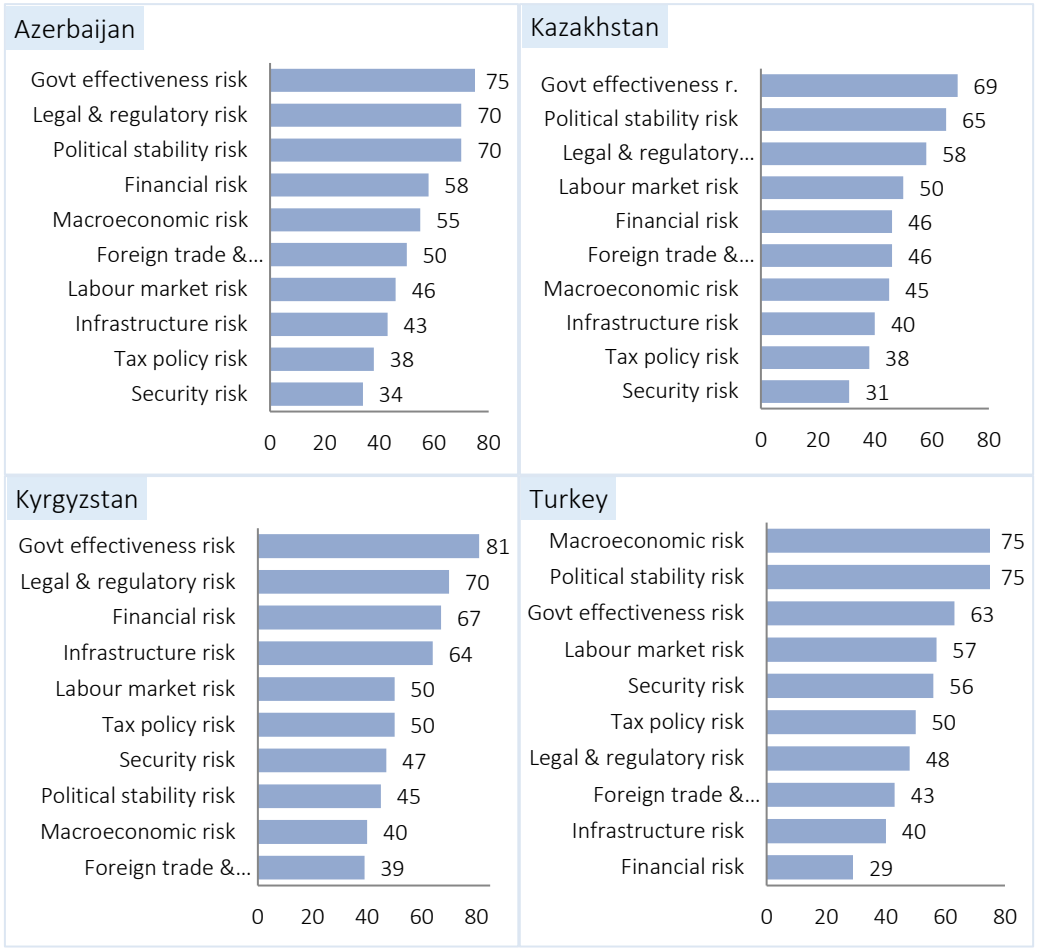
Figure 6.9: The Economist Intelligence Unit Risk Classification of Turkic Council Countries, 2018



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

Legal and regulatory risk was placed among top three areas of concern in Azerbaijan, Kazakhstan and Kyrgyzstan. In a similar vein, political stability was identified as an area with a relatively high risk score in Azerbaijan, Turkey and Kazakhstan. In Turkey, the macroeconomic risk score was found to be very high (75) whereas in Kyrgyzstan it was relatively low (40). On the other hand, security risk scores of Azerbaijan (34) and

Figure 6.10: Distribution of Risk Scores in Turkic Council Countries, 2018



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

Kazakhstan (31) were the lowest (less risky) among TC MCs. The detailed risk scores of TC MCs reveal that investors and firms face a wide range risks in their business life from government effectiveness to tax policy risk. Nevertheless, some of these areas with high risks in TC MCs are similar such as the government effectiveness and political stability. In this regard, TC MCs may join their forces to find out ways on how to address these common areas of concern by benefiting from the Turkic Council platform. In particular, each country has unique experiences and best practices. For instance, Turkey has a good experience on managing financial risks whereas the experiences of Kazakhstan and Azerbaijan on minimizing tax policy risk are important to consider. Establishment of a cooperation framework at the Turkic Council level would help to facilitate share of knowledge and expertise among TC MCs in such areas of common concern.

Overall, the figures suggest that a majority of TC MCs are still not able to set up favourable economic frameworks to provide the foreign businesses with adequate regulatory as well as physical infrastructure to attract more FDI flows and host remarkable amount of FDI stocks given their high potentials. Many of them still have relatively high level of risk scores independent from

how the risk is measured. Consequently, TC MCs, in general, need to take swift measures to foster an environment conducive to attracting more foreign investments. To achieve this goal, reforms are needed to improve the business climate and to introduce investment incentives tailored to the needs of both domestic and foreign investors. This, in turn, requires building adequate infrastructure as well as investing in modern technologies to enhance their productive capacities, which is still a significant challenge to majority of them.

Annex

Table 6.A1: Selected Completed Reforms to Ease Doing Business in 2017-2018

	Azerbaijan	Kazakhstan	Kyrgyzstan	Turkey
Starting a business		Kazakhstan made starting a business easier by reducing the time required for value added tax registration.		Turkey made starting a business easier by removing the paid-in minimum capital requirement and by eliminating the notarization of company documents and legal books.
Dealing with construction permits	Azerbaijan made dealing with construction permits easier by streamlining its construction permitting process. Construction permits are now issued only by the Baku City Executive Office's single window.			Turkey increased the transparency of its building regulations by publishing online all pre-application requirements needed to obtain a construction permit. Turkey also strengthened construction quality control by imposing stricter qualification requirements for professionals in charge of approving architectural plans.
Getting electricity	Azerbaijan improved the reliability of power supply by investing in grid infrastructure and establishing a national regulator to monitor power outages. Azerbaijan also made getting electricity faster and less costly by establishing a single window.			
Registering property	Registering property Azerbaijan made registering property easier by increasing the transparency of the land administration system.			

Getting credit	Azerbaijan strengthened access to credit by introducing a new secured transactions law and insolvency law, which implemented a functional secured transactions system, broadened the scope of assets that can be used as collateral and provided secured creditors with grounds for relief and time limits during an automatic stay. Azerbaijan also set up a unified, modern and notice-based collateral registry, and improved access to credit information by establishing a new credit bureau.			Turkey strengthened access to credit by extending the security interest to products, proceeds and replacements of the original collateral; secured creditors are now given absolute priority over other claims, such as labor and tax, both outside and within bankruptcy proceedings. Turkey also improved access to credit information by reporting data on arrears from telecommunications companies
Protecting minority investors	Azerbaijan strengthened minority investor protections by increasing shareholders' rights and role in major corporate decisions, clarifying ownership and control structures and requiring greater corporate transparency.			
Paying taxes	Azerbaijan made paying taxes easier by introducing electronic invoicing (e-invoicing) and a unified tax return for social security contributions and enhancing the online platform for filing corporate income tax.			Turkey made paying taxes easier by improving the online portal for filing and payment of taxes.
Trading across borders	Azerbaijan made trading across borders faster by streamlining electronic customs procedures and fully implementing the "green corridor" gating system.	Trading across borders Kazakhstan made trading across borders easier by introducing an electronic customs declaration system, ASTANA-1 IS, as well as reducing customs administrative fees.	Kyrgyzstan made trading across borders easier by streamlining exports within the Eurasian Economic Union.	Turkey reduced the time and cost to export and import through various initiatives, including expanding the functionalities of the national trade single window, enhancing the risk management system and lowering customs brokers' fees.

Enforcing contracts		Kazakhstan made enforcing contracts easier by making judgments rendered at all levels in commercial cases publicly available and publishing performance measurement reports on local commercial courts.	Kyrgyzstan made enforcing contracts easier by introducing a pretrial conference as part of the case management techniques in court and adopting a consolidated law on voluntary mediation.	Turkey made enforcing contracts easier by publishing judgments rendered at all levels in commercial cases and by introducing financial incentives for mediation.
Resolving insolvency	Azerbaijan made resolving insolvency easier by providing for the avoidance of preferential transactions. Labor market regulation Azerbaijan changed regulations pertaining to the notice period for redundancy dismissals and severance payments.		Kyrgyzstan made resolving insolvency easier by facilitating the continuation of the debtor's business during insolvency proceedings and granting creditors greater access to information on the debtor's financial situation during the proceedings.	Turkey made resolving insolvency easier by introducing the possibility to obtain post-commencement credit, improving voting arrangements in reorganization and granting creditors greater participation in the proceedings.

Source: Adapted from Doing Business Report 2019

7 Sectoral Analysis on Investment Potentials among TC MCs

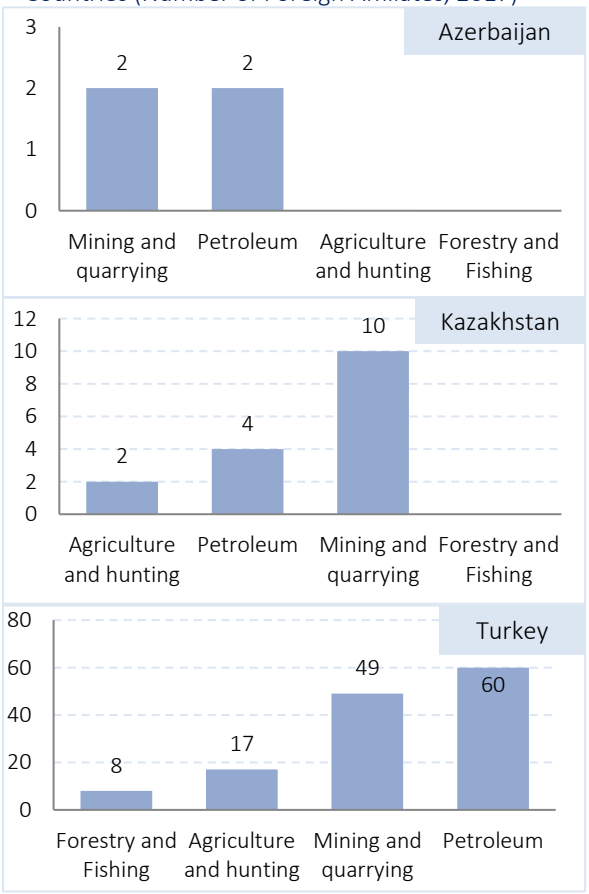
This chapter provides a sectoral analysis on investment potentials among TC MCs by looking into the state and distribution of foreign investors in various subsectors. In this way, the chapter aims to identify the sectors that have higher potential and competitiveness to attract foreign investors both from TC MCs and beyond.

7.1 Identifying Sectoral Investment Potentials

Identification of sectoral investment potentials is a daunting task. Each multinational company and foreign investor have their own priorities and risk understanding. Sometimes one investor may go into a subsector by assuming not having net profits for a certain period of time. Another investor may choose to go into a subsector to economically harm its rival company by accepting some net negative return for a designated time. Although it is not easy to detect the real intention and motivation of a certain investor, one can expect that the collective movement of investors should be in line with the economic theory that economic agents aim to maximise their profits. In this regard, the sectoral concentration of foreign investors could give an overall idea about the economic potentials and chances of profit maximisation in various economic sectors.

Table 7.1 presents the sectoral concentration of foreign investors in TC MCs in 2017 based on the number of foreign affiliates. In all TC MCs, the

Figure 7.1: Sectoral Distribution of Foreign Affiliates in the Primary Sector in Turkic Council Countries (Number of Foreign Affiliates, 2017)



Source: Investment Map, IntraCen 2019. Note: SESRIC Staff Calculation based on Number of Foreign Affiliates

ranking of sectors is the same. The tertiary sector got the lion share of foreign investors in the range of 57.7% (Turkey) and 83.3% (Kyrgyzstan). The secondary sector emerged as the second important sector in terms of sectoral concentration of foreign affiliates in TC MCs. It hosted 16.7% of foreign investors in Kyrgyzstan and in Turkey its share went up to 39.9%. The

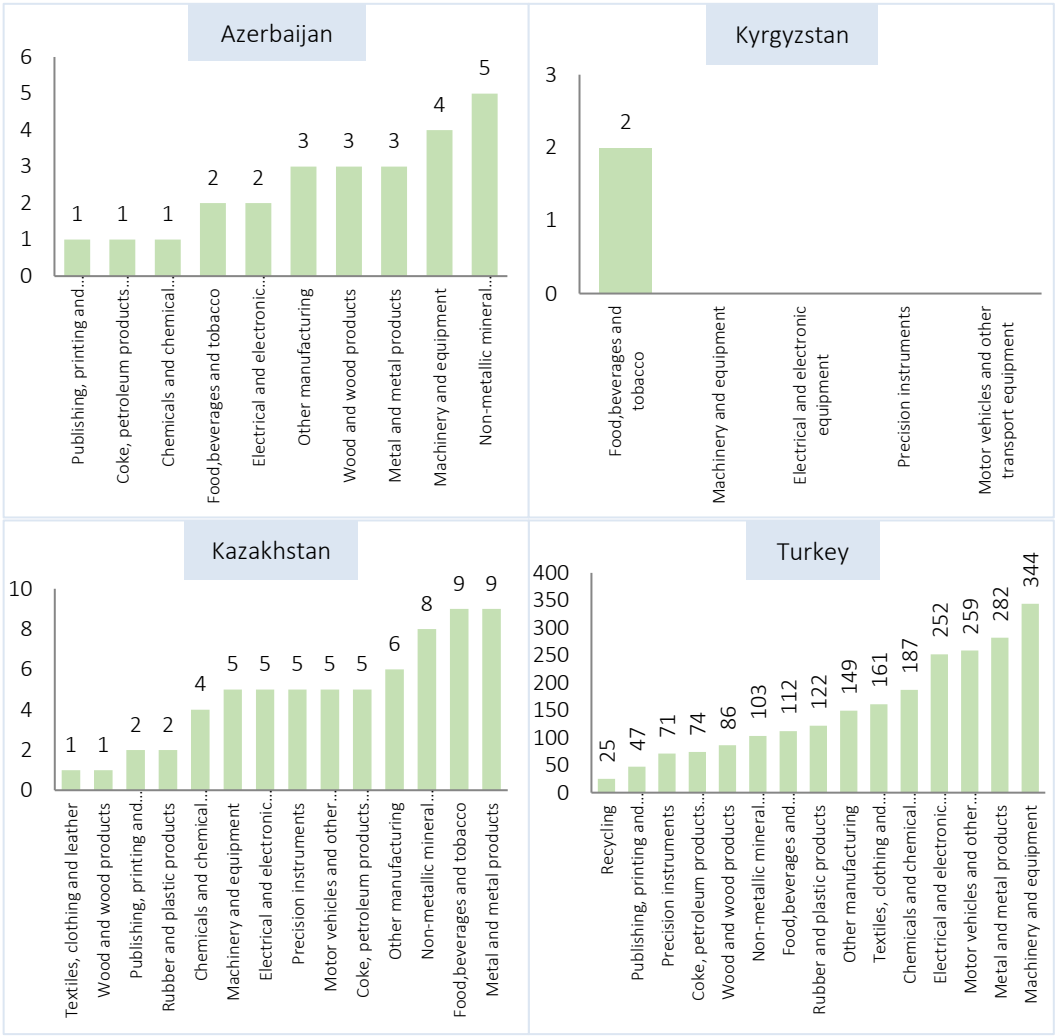
Table 7.1: Sectoral Concentration of Foreign Investors in Turkic Council Countries, 2017

Share in the total number of foreign affiliates

	Primary	Secondary	Tertiary
Azerbaijan	3.8%	23.8%	72.4%
Kazakhstan	7.2%	30.0%	62.8%
Kyrgyzstan	0.0%	16.7%	83.3%
Turkey	2.4%	39.9%	57.7%

Source: Investment Map, IntraCen 2019. Note: SESRIC Staff Calculation based on Number of Foreign Affiliates.

Figure 7.2: Sectoral Distribution of Foreign Affiliates in the Secondary Sector in Turkic Council Countries (Number of Foreign Affiliates, 2017)



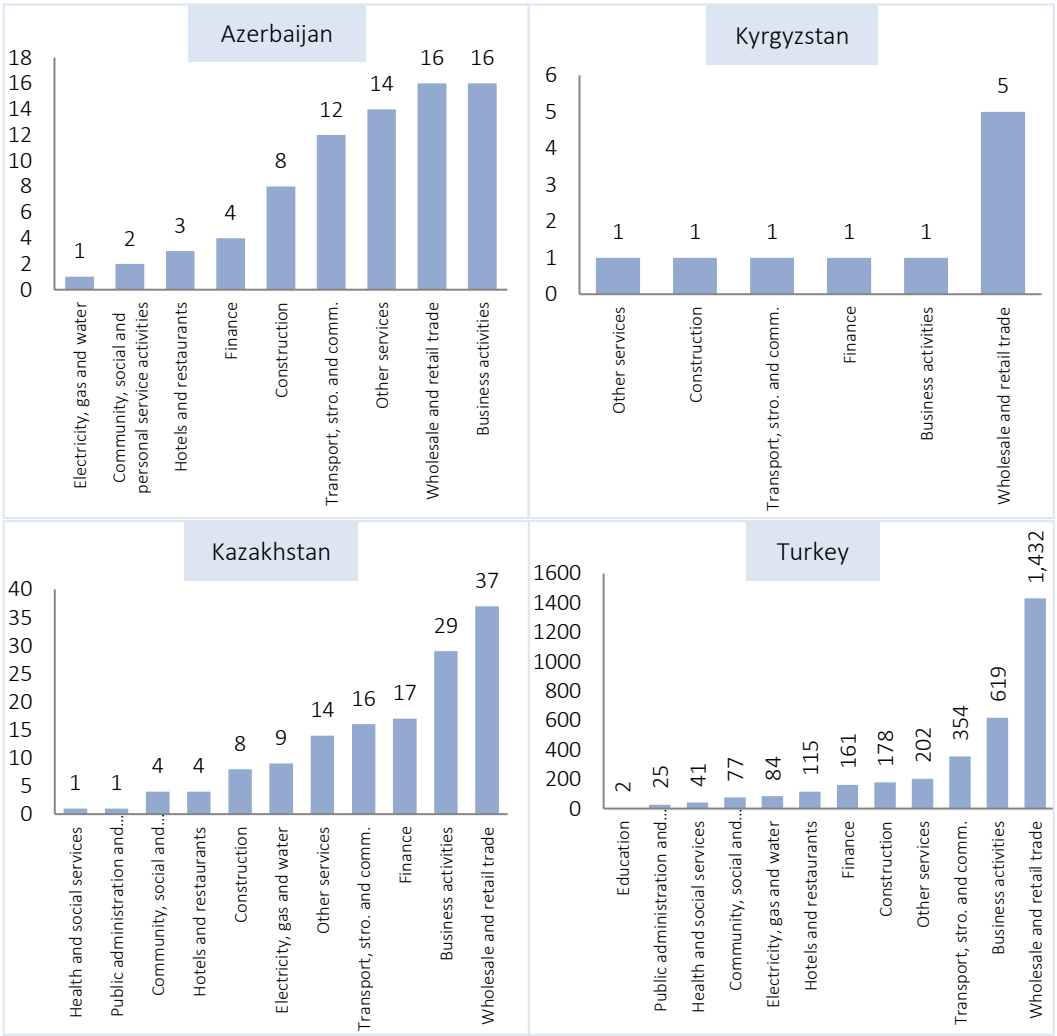
Source: Investment Map, IntraCen 2019. Note: SESRIC Staff Calculation based on Number of Foreign Affiliates

highest level of sectoral concentration in the primary sector was observed in Kazakhstan (7.2%) and was followed by Azerbaijan (3.8%).

Overall, the tertiary sector is the most attractive one for foreign investors in TC MCs that many of them chose to invest in that sector. Nevertheless, the secondary sector is also strong and competitive both in Turkey and Kazakhstan that more than one third of foreign investors went into that sector. Finally, the primary sector hosted limited number of foreign investors in TC MCs but in Kazakhstan the share of foreign investors in that sector exceeded 7% that may reflect high potentials for investment.

Figure 7.1, 7.2 and 7.3 provide a more detailed picture on how foreign affiliates in TC MCs are distributed in subsectors of the primary, secondary and tertiary sectors. According to Figure 7.1,

Figure 7.3: Sectoral Distribution of Foreign Affiliates in the Tertiary Sector in Turkic Council Countries (Number of Foreign Affiliates, 2017)



Source: Investment Map, IntraCen 2019. Note: SESRIC Staff Calculation based on Number of Foreign Affiliates

Azerbaijan had 2 foreign affiliates in the mining and quarrying and 2 in the petroleum subsectors. Turkey had 60 foreign affiliates in the petroleum subsector. On the other hand, Turkey (49) and Kazakhstan (10) hosted a significant number of foreign affiliates in the mining and quarrying subsector.

According Figure 7.2, in Azerbaijan the highest number of foreign affiliates in the secondary sector was recorded in non-metallic mineral products subsector (5). In Kyrgyzstan, it was the food and beverages subsector. In Kazakhstan and Turkey, the number of foreign affiliates are relatively higher in the metal and metal products subsector. Turkey hosted 282 foreign affiliates in that sector. Moreover, Turkey hosted more than 340 foreign affiliates in the machinery and equipment subsector. Finally, in Kazakhstan the food and beverages subsector was found to be relatively attractive that hosted 9 foreign affiliates in that sector.

According Figure 7.3, in Azerbaijan the highest number of foreign affiliates in the tertiary sector was recorded in business activities and wholesale and retail subsectors. Each subsectors hosted 16 foreign affiliates. The number of foreign affiliates in the wholesale and retail subsector was found to be 5 in Kyrgyzstan, 37 in Kazakhstan, and 1,432 in Turkey. Accordingly, the wholesale and retail subsector was the leading subsector in all TC MCs in 2017 in terms of the number of foreign affiliates in the tertiary sector. It was followed by the business activities subsector in all TC MCs. In Kazakhstan and Kyrgyzstan, the number of foreign affiliates were high in the finance subsector that made it third sub-sector after the wholesale and retail trade and business activities in terms of foreign affiliates. Finally, in Turkey the third subsector in terms of the number of hosted foreign affiliates was the transport, storage and communications where more 354 of them had business operations.

7.2 Concluding Remarks

Overall, the results reveal that TC MCs have some similarities in terms of their subsectoral competitiveness for foreign affiliates. For instance, as an oil rich country, Azerbaijan needs to attract more investment into its petroleum subsector. Nevertheless, Turkey hosts already 60 foreign affiliates in that subsector. The Turkic Council regional cooperation platform would help to identify such areas of cooperation in attracting foreign investors into selected strategic sectors where member states could exchange their national experiences and knowledge with each other. Moreover, if TC MCs could identify existing investment gaps in specific subsectors in their national economies, they could also work on developing some frameworks to guide and encourage their national investors into the Turkic Council region.

Meeting all SDGs with given level of domestic resources is not possible for many TC MCs. In this regard, international resources have the potential to play a constructive role in the efforts of TC MCs to achieve sustainable development. Nevertheless, the existing regulatory frameworks, certain restrictions and uncertainties limit the amount of investment flows directed to TC MCs. Therefore, by benefiting from the potential constructive role of the Turkic Council as a regional cooperation platform, TC MCs must altogether scale up their efforts to improve their investment climate and increase the prevailing level of economic cooperation among each other. There are

many ways of achieving these ambitious goals that can only be achieved through tireless efforts and strong political willingness and commitment.

At the technical level, development of a Turkic Council Joint Investment Area, elimination of cross-border investment barriers among Member States of the Turkic Council, easing visa regimes, reducing tariffs and non-tariff barriers for trade, establishment of Turkic Council Arbitration Centre and an investment dispute settlement mechanism would be among some policy options that need to be elaborated at relevant foras of the Turkic Council with a view of increasing investment flows among Turkic Council Countries as well as helping some economic subsectors to take off by attracting certain level of investments.

PART IV: A Roadmap for Enhancing Economic Cooperation

This Part includes the following chapters:

8 Policy Issues for Creating and Maintaining a Strong Economic Cooperation

[Requires field visits and survey to be completed]

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