

**TRADE, TRANSPORT AND TELECOMMUNICATIONS IN THE SOUTH
CAUCASUS: CURRENT OBSTACLES TO REGIONAL COOPERATION**

CONTENTS

- I EXECUTIVE SUMMARY**
- II REGIONAL PROJECTS IN THE SOUTH CAUCASUS**
- III POTENTIAL TRADE BENEFITS FROM THE OPENING OF BORDERS**
- IV EXPORTS AND TRANSPORT COSTS**
- V TELECOMMUNICATIONS AND INTERNET**
- VI TOURISM**
- VII OBSTACLES TO TRADE**
- VIII CONCLUSION**

Annexes

- 1 Recommendations for Action at the Regional Level**
- 2 Recommendations for Armenia**
- 3 Recommendations for Azerbaijan**
- 4 Recommendations for Georgia**
- 5 Priority Activities after Conflict-Resolution**

TRADE, TRANSPORT AND TELECOMMUNICATIONS IN THE SOUTH CAUCASUS: CURRENT OBSTACLES TO REGIONAL COOPERATION

EXECUTIVE SUMMARY

Nearly a year ago, in the context of growing hopes for a peace settlement in Nagorno-Karabakh, the World Bank commissioned a series of studies of transport, trade and telecommunications infra-structure in the three South Caucasus states. The six studies looked at current issues and future prospects in the region for trade flows, trade facilitation, roads, railroads, telecommunications and tourism

The basic premise of these studies is that for the region as a whole, the major economic benefit from a peace settlement will come from the benefits of trade. The re-opening of borders would permit normal trade between the three countries and with their immediate neighbors: Turkey, Russia and Iran. This, in turn, would enable Armenia, Azerbaijan and Georgia to use their advantageous geographic position, natural resources and human capital to reach new markets and expand exports. This would stimulate increased foreign investment, rapid economic growth, job creation and poverty alleviation.

The purpose of the studies is to consider the steps needed to achieve this “virtuous cycle” of border openings leading to increased trade and prosperity. What investments and activities can donors and governments undertake to transform this vision into a reality? Should we wait for a peace treaty before tackling these problems or can we do anything now? And can problems be solved by individual countries, or do they require a regional approach?

A common theme emerging from these six studies is that closed borders, blockades, and war-damaged infrastructure provide only a partial explanation for the dramatic drop in exports of the three countries. Even in areas where no serious political obstacles to commerce exist, there are institutional, bureaucratic and structural barriers to trade that will need to be lifted, before trade will expand and the countries can reap any substantial economic benefits from a re-opening of borders. To quote *Trade Facilitation in the Caucasus*: “In the long run a peace settlement will only generate widespread and sustainable benefits, if the institutional and physical milieu is sufficiently supportive. The realization of these potential benefits appears highly unlikely, at present, as the current institutional and physical milieu is anything but supportive and offers few incentives for new development.”

It is worth emphasizing that if these problems are not dealt with before a peace settlement is reached, the likelihood of the populations of the three countries deriving visible economic benefits from an agreement – and continuing to support whatever political tradeoffs are necessary for peace – is far smaller. For this reason, this paper falls into the category of post-conflict work.

This summary paper provides a synthesis of some of the key insights and recommendations of the six studies, but concentrates on those that can be implemented under the current circumstances, i.e. without a peace accord.¹² This paper is narrowly focused on current barriers to trade, transport and tele-communications in the region. It does not deal with political issues, nor with the underlying structural problems that underpin poor export performance, i.e. barriers to investment and production, weak marketing and financial systems, etc. Our purpose here is to answer a much more limited set of questions:

- **What are the current key obstacles to trade, transport and telecommunications in the region?**
- **Which of these obstacles can be tackled under current conditions, and how can they best be tackled?**

We are looking, in particular, at telecommunications and internet development in the region, not merely for its intrinsic contribution to economic development, but because it offers a new vehicle for facilitating economic cooperation and interaction between individuals, businesses and governments, despite political barriers. In addition, the internet can play a critical role in breaking down the geographic isolation all three countries face, and permitting contact with the world beyond their borders.

We are also building on the experience of the Trade and Transport Facilitation in South East Europe Project (TTFSE) where international organizations have been working with public and private sector groups in six neighboring states to achieve significant improvements in trade facilitation in a region where wars, political animosities, and economic collapse have destroyed old trade patterns and stymied the establishment of new ones.

To follow up on these six studies, we intend to co-sponsor a South Caucasus Trade Facilitation Workshop in Tbilisi in June 2001 conference in the region, to outline potential trade facilitation efforts through two main themes: trade and transport facilitation, and regional information infrastructure and e-commerce/e-government.. Our purpose will be to gather stakeholders from the three countries to share information on trade facilitation activities elsewhere, initiate the creation of business-government committees to facilitate trade and transport and begin to develop a Regional Information Infrastructure Strategy.

¹ The full studies provide a much larger range of recommendations than those summarized in this paper and include proposals for investments and projects in the event of a peace agreement. The papers are entitled “*Changing Trade Patterns after Conflict Resolution in South Caucasus*” “*Trade Facilitation in the Caucasus*” “*Armenia and Azerbaijan: Post-Conflict Study – Road Transport*” “*Post Conflict Study of Railways in Armenia, Azerbaijan, Georgia and Turkey*” “*Regional Study on Telecommunications in the Caucasus*” and “*Regional Study on Community-Based Tourism in the Caucasus.*” All six studies, along with summaries and terms of reference are available on the World Bank Internet site under “South Caucasus Regional Cooperation.”

REGIONAL PROJECTS IN THE SOUTH CAUCASUS

The six studies were begun at a time when the Nagorno-Karabakh peace negotiations were on a fast track, and the international community was considering how best to prepare for post-conflict reconstruction in the region. The purpose of the studies was threefold:

1. To prepare projects to rebuild/upgrade transport, communications and trade facilitation infra-structure that could be implemented as soon as peace agreements are signed.
2. To analyze the potential for change in the region's trade flows that could result from lowering transport costs and opening borders to legal trade with neighboring countries;
3. To consider institutional capacity and arrangements needed to foster regional economic development and trade, and propose changes where necessary;

Two of the six studies, "*Armenia and Azerbaijan: Post-Conflict Study – Road Transport*" and "*Post Conflict Study of Railways in Armenia, Azerbaijan, Georgia and Turkey*" fit in the first category. They prioritize the key investments that will be necessary to reconnect the major roads and railroads in the region, and estimate their costs. Further preparation for these investments--in particular, inspection of road and railroads in conflict areas and border regions-- will not be possible until peace negotiations have made more progress

POTENTIAL TRADE BENEFITS FROM THE OPENING OF BORDERS

One study "*Changing Trade Patterns after Conflict Resolution in South Caucasus*" is in the second category. It examines the likely short-term impacts of the lifting of blockades, particularly in the areas of export creation, energy trade and transport savings. It points out that there are many overly optimistic expectations in the region about the ease of realizing these potential "peace dividends." In large measure, the strength of each country's supply response to the opening of markets will determine the benefits it derives. While regional trade will be boosted by conflict resolution, a major increase in exports to developed nations will not happen without a serious industrial restructuring. Many of the current obstacles to production and trade are likely to constrain the three states' ability to benefit from the newly created economic opportunities.

The conservative estimates of the potential benefits due to trade normalization are summarized below.

Table 1. Selected potential effects of trade normalization in South Caucasus

(Million U.S. dollars)

	<i>Armenia</i>	<i>Azerbaijan</i>	<i>Georgia</i>
Transport savings	6.4-8.4	0.7-1.8	
Savings from using lower-cost energy	45		
Missing exports	268.9-342.4	103.2-104.6	
Including: gravity model ³	38.9-72.4	3.2-4.6	
natural resources/energy	255-296	100	
Total effect	320.3-395.8	103.9 – 106.4	
Complementary imports	80-100		
Total effect minus complementary imports	220.3-315.8	103.9 – 106.4	
As percent of 1999 trade deficit	38-54	25 - 26	
Loss of transit revenues			7.4
As percent of 1999 trade deficit			1.4

Source: Author's calculations.

³ A gravity model proposed was used to estimate missing exports in South Caucasus. The model links intensity of international trade between pairs of countries with the countries' GDP levels, populations, and distance between the countries.

Potential peace benefits are highest for Armenia, the country that suffers most from the blockades. Armenia would annually save 6-8 million dollars on the transport costs of non-energy imports and 45 million dollars on switching the flows of natural gas and petroleum products to new sources. Though this reduction in transportation services would be shared between domestic and foreign providers, most of it would reduce current deficit, because foreign transport companies dominate the market and their services are shown as debit in the balance of payments. The potential increase in exports would range from 269 to 342 million dollars a year, more than doubling total exports. At the same time, the complementary imports necessary to sustain this increase in exports would stand at around 100 million dollars. The resulting improvement in the balance of payments would exceed 220 million dollars, or 38 percent of the current trade deficit.. The potential new export volume equal 15 - 19 percent of gdp. However, exports are likely to have a multiplier effect on gdp. Assuming a (modest) multiplier of 2.0, the increase in exports may lead to up to 30 - 38 percent of gdp growth.

Azerbaijan could increase its exports by 100 million dollars, or 11 percent of the current level, slashing the trade deficit by a quarter. As a result, gdp would increase up to five percent.

Georgia might face a reduction of transit through its territory. Nevertheless, it is unlikely to exceed a quarter of the freight service surplus in the bop, or 1.5 percent of trade deficit. At the same time, the country would benefit from the effects of regional cooperation. The most obvious example would be the integration of the electric power systems that would bring about large efficiency gains.

In the electric power sector, the greatest efficiency would be achieved if the south Caucasus countries and their neighbors operated as one system. This would economize particularly on generation capacity investments. It would also allow for more economic dispatch.

Overall, the lifting of blockades will result in an alleviation of trade distortions, bringing about positive short-term welfare effects including more rational trade flows; resumption of regional trade in some major commodities such as energy and lower prices and/or higher profit margins on some important consumption and production goods. However, unless there is progress on tearing down the obstacles to trade listed below, none of the three countries will be able to take full advantage of the new export opportunities resulting from a border opening.

EXPORTS AND TRANSPORT COSTS

Two of the studies, "*Changing Trade Patterns after Conflict Resolution in the South Caucasus*" and "*Trade Facilitation in the Caucasus*" provide dramatic evidence of the drop in trade that all three countries of the south Caucasus have suffered. While the economic collapse of the early 90s is well known, it is important to note that economic stabilization has brought very little export recovery in the second half of the 1990s. Armenian and Georgian exports have stagnated over the past four years; as have

Azerbaijani exports in the non-oil sector. A few statistics from the reports dramatize the degree to which actual trade flows have fallen below predictions and infra-structure capacity:

- On average less than 1 truck per day passes the Georgian-Armenian border at Sadakhlo.
- 8-10 trucks pass the Azerbaijan-Georgian border at the Red Bridge border crossing, of which 60% are transit traffic.
- The port of Baku is utilizing 13% of total capacity.
- The new freight terminal at Yerevan's Zvartnots Airport is operating at below 20% capacity.

All three Caucasus countries run high trade deficits; in Armenia and Georgia, they are unsustainable, even in the medium-term. Throughout the second half of the 1990s, the deficit to exports ratio has ranged from 162 to 252 % in Armenia, and 162 to 232 % in Georgia. The Azerbaijani deficit has been lower – between 40 and 154 % of exports. As exports have plummeted, it is both symbolic and noteworthy that scrap metal has emerged as a major export category for all three states. Dismantling the old Soviet industrial legacy is not, however, a sustainable long-term export strategy

The drop in exports concerns services as much as goods. As the “*Regional Study on Community-Based Tourism*” notes, in Soviet times, the tourist industry was a major economic contributor to all three states, especially Georgia. Despite some recovery since 1995, the number of visitors to the region in 1997 was less than 10% what it was in the 1980s.

While there are a number of reasons for the lack of competitiveness of exports in the three states, the studies clearly demonstrate that high transport costs and widespread corruption place a heavy burden on would-be exporters. All three states suffer from a high overall freight factor (defined as the ratio of freight costs to the value of merchandise in BOP) which is more than five times the EU average. Some relevant statistics:

- Moving a container from Bandar Abbas to Baku takes 10-12 days by road and costs \$700-800; moving the same container from Baku to Poti takes only 3-5 days by road but costs \$2200.
- The first 700 km of the 2200km between Yerevan and Moscow account for 80% of the total cost of moving a consignment.
- The movement of refrigerated food from Riga to Uzbekistan is \$100 per ton cheaper than an equivalent movement from Poti to Uzbekistan.
- Illegal imports into Georgia are estimated to amount to somewhere between 30% and 70% of total domestic demand for some commodities.

- Shipments in Azerbaijan require an ex ante “facilitation payment” of between \$500-1500 per consignment.

TELECOMMUNICATIONS AND INTERNET

One of the six studies focuses on the barriers to telecommunications and internet development in the region. With the breakup of the USSR, all three Caucasus countries inherited relatively extensive, but low quality and inefficient fixed telephony networks. There is a growing interest from regional players to enter the South Caucasus telecom markets, which, although currently small, have tremendous potential for growth, especially in the area of mobile communications. Most of these players perceive the three countries as one single market from their business development plans, but run into the hurdle of disparate and mutually inconsistent regulatory frameworks. In particular, different licensing, interconnection and tariff regulations make it difficult for any of these would-be regional operators to pursue a regional strategy.

While the three states have adopted different regulatory regimes, sector development has been constrained by a common set of regulatory bottlenecks. These include non-competitive and inconsistent licensing, lack of clear build out obligations in license agreements, interconnection and revenue sharing issues among operators, unbalanced tariffs, and lack of capacity to manage scarce resources such as numbering or frequencies.

Internet access is limited to a mere 4000 users in Armenia, 5000 in Georgia and 9000 in Azerbaijan, despite very high literacy rates and highly skilled IT specialists. The paucity of telephone infrastructure, particularly the low digitalization of the publicly switched network, hampers advances in internet connectivity and data transfer speed. The high cost of leased lines and in particular of international connectivity is an even more important bottleneck. This is particularly problematic in Armenia where all operators wishing to transmit data abroad still have to rent their international link from Armentel.

The current state of development of the Internet in the region is highly inefficient, since most of the traffic is routed via the US, independently of whether it is addressed to a local or foreign counterpart. This situation causes an added and unnecessary burden on expensive and scarce international internet connectivity which could be mitigated through the creation of a regional hub in which the major ISPs in the region would interconnect and exchange traffic among themselves.

TOURISM

The sixth study “*Regional Study on Community-Based Tourism in the Caucasus*” focuses on the potential for revival of the tourist industry, previously an important source of revenue and employment in all three states. The region’s tourism potential remains strong, due to the richness of its varied cultures, architecture and landscapes, but wars,

civil strife, blockades and inappropriate economic policies have reduced tourist revenues to a trickle. In addition to the deterioration of facilities and infra-structure over the past decade, the study lists a series of bureaucratic and institutional obstacles that are preventing the three states from developing new markets. It points out that the South Caucasus region possesses a unique character that is well suited to the fast growing and increasingly diversified sustainable tourism market, but to be successful, the three states need to be marketed as a regional entity, and travel between the three states facilitated. It recommends adoption of a community based model that would stimulate economic development in rural areas, and provide incentives for conservation of the countries' cultural heritage and natural assets.

OBSTACLES TO TRADE:

The six papers identify large number of specific obstacles to trade. A common theme is that institutional weaknesses, not just infra-structure problems and political conflicts are responsible. For summary purposes we have divided the obstacles into six categories.. The final section consists of recommendations from the six studies of ways to overcome these obstacles. Neither the list of obstacles, nor the list of recommendations is intended to be an all-inclusive list. Rather, they are meant to be a basis for discussion and action by stakeholders from the three countries, donors and international organizations. It is clear that not all of these obstacles are liable to solution in the current political situation, but many of them clearly are.

Political Obstacles

- Closed borders between Azerbaijan and Armenia and between Armenia and Turkey;
- Multiplicity of trade regimes in the region, i.e. CIS Agreements, WTO membership, EU aspirations, etc.

Infrastructure Obstacles

- Roads: Condition of road infra-structure, comprising the TRACECA highway is, at present, generally poor, with the surface displaying considerable cracking in many places.
- Railroads: Condition of rail restrictions, antiquated rolling stock, lack of reliable shunting stock and lack of essential maintenance. Current performance is hampered by widespread use of antiquated tariffs, little apparent integration and limited institutional capacity. Armenia is not included in the Xerox/Baku railway tariff agreements. International tariff agreements are of limited effectiveness.
- Power: Frequent interruptions in power supply in Georgia and to a lesser extent in Azerbaijan disrupt production in key export sectors, disrupt transport by rail for domestic and transit traffic and significantly reduce the lifting capacity at Poti.

Border Crossing/Customs Obstacles

- Little formal integration or formal communication between the respective national Customs services in the three countries.

- Limited cooperation across agencies.
- Principal border crossing stations vary markedly in terms of staff and facilities. However even the best seem to have little additional physical capacity to deal with any future increases in traffic volume, and are likely to be the source of recurrent and substantial delay.
- Introduction of pre-shipment inspection in Georgia does not appear to have been successful with widespread condemnation both of the process and the concomitant delays.
- The current procedures operated on the Armenian border are cumbersome and time-consuming, and do little to facilitate trade development.
- All 3 states face a major challenge in streamlining and increasing the efficiency of border agencies customs, and reducing corruption in customs administration.

Tax, Regulatory and Economic Policy Obstacles

- There are a number of instances where domestic privatization processes have either created or contributed to the establishment of a local monopoly. In some cases, the resulting position is being utilized to reduce competition and increase costs – Baku Bina airport and Armentel being prominent examples.
- Inequalities in import tax and road taxes lead to corruption and higher costs. Road taxes on foreign vehicles should be reduced on a reciprocal basis and import taxation for all flows should be equalized.

Public Sector Obstacles

- Rent-seeking behavior on the part of public officials is an endemic problem across the three countries, varying only in nature and intensity.
- Public sector extremely bureaucratic; rules changed in arbitrary rule; interpretation and application rigid and pernicious.
- In particular, there is an urgent need to eliminate the unofficial extortion on the road (especially in Georgia & Azerbaijan).

Private Sector Obstacles

- Limited formal consultation between public and private sectors in the area of trade facilitation.
- Private sector representative bodies vary markedly in terms of institutional capacity and resource base.
- Problems in respect to cost of credit and availability of export credit guarantees across the three countries.

The papers propose a wide array of recommendations to overcome current obstacles to trade, transport and telecommunications between the three countries, and with their neighbors. The recommendations are presented in the five annexes to this paper. The first annex presents recommendations for practical activities at the regional level, which could be undertaken now. The next three annexes present recommendations for the individual countries in the region. (Annex 2 – Armenia; Annex 3 – Azerbaijan; Annex 4 - Georgia) Annex 5 presents recommendations for actions that need to be undertaken at the regional level, but will not be possible until the current conflict has been resolved.

To follow up on these six studies, the World Bank will co-sponsor a workshop in Tbilisi in June, entitled “Caucasus Trade Facilitation Workshop: A Transport, Information Infrastructure and E-commerce Perspective.

The **trade facilitation module** will focus on defining pragmatic short and medium-term solutions to facilitate trade between the Caucasus region and outside trade partners, and within the Caucasus. It will gather the main parties involved in trade in the three Caucasus countries from both the private and public sector. The conference will build on the report “Trade Facilitation in the Caucasus (October 2000)” and expand this report to cover railway border-crossing issues. Other participants, including TRACECA and the UNECE will be invited to participate actively in the conference.

The conference will offer an opportunity to initiate the creation of national facilitation committees. Such committees, including business and administration representatives, have enabled significant improvements in trade facilitation in neighboring countries such as in Southeast Europe. Facilitation committees would provide ultimately an effective forum for targeted and systematized interactions on trade issues.

The **Regional Information Infrastructure Module** aims at bringing together policy-makers and regulators from all three South Caucasus countries in order to raise awareness toward the need for a harmonized regional approach in telecommunications and information technology as an enabler of economic efficiency and improved delivery of public services. As a trigger for discussion, a short consultation document will be developed and then discussed at the workshop, with participants from the public and private sector, as well as from donor organizations and NGOs active in the field of communications, as well as health, education and other public services. The conference will aim at agreeing on a common action plan and endorsing concrete development projects in three possible areas: (i) internet development and e-commerce, (ii) regulatory capacity building and (iii) universal access.

ANNEX 1

RECOMMENDATIONS FOR ACTION AT THE REGIONAL LEVEL

Trade Facilitation

- Align and reduce road taxes on foreign vehicles on a reciprocal basis;
- Strengthen formal cooperation across border agencies and across borders at the border stations. One approach would be to designate a limited number of joint pilot projects where the immediate objective would be to strengthen the integration between the different agencies across borders.
- Introduce systematic performance measurement at border crossing and inland terminals;
- Assess the potential benefits of introducing and integrating computerization into the customs and border crossing facilities, on an extended basis in the three countries. One key element of the approach would involve the extension of the ASYCUDA system across the 3 countries;
- Assess the benefits of harmonizing tax codes across the three countries to try to ensure that the current anomalies and concomitant distortions are removed; equalize import taxation for all flows.
- Create, in each country, trade facilitation commissions gathering business and government participants and stimulate their systematic interactions at a regional level.
- Develop regional vocational training programs for trade, transport and logistic professionals to ensure similar quality standards.

Telecommunications

- Establishment of a Regional Internet Exchange Point. This arrangement would allow local traffic to be routed locally, pool together the international traffic and ; therefore, achieve lower tariffs through a more efficient use of international circuits which would be priced at wholesale, rather than at retail rates. At present, Georgia would appear to be the most viable location for establishing such an exchange point, given the geography, politics and the emergence of regional infrastructure.
- Regional Information Infrastructure strategy: In the current context, only Georgia has taken the first steps towards the development of an information infrastructure strategy that looks beyond the development of the IT and telecommunications sector as a pure conduit, and contemplates a broader approach that takes into account the content and application perspective. This implies defining standards and best practices for creative and productive use of IT in education and health, as well as in the relationship between government, businesses and the public in general, through so-called e-government and e-commerce initiatives. A number of issues regarding data protection, privacy, digital signatures, promotion of local content, etc. need to be discussed and can be better addressed at the regional level.

- Use the platform provided by two World Bank programs, the Global Distance Learning Network and World Links for Development (WorLD), to respectively support the development of distance learning institutions and programs as well as facilitate the use of information technology in schools across the region.
- Use the platform provided by the World Bank Global Development Gateway initiative to establish a unified South Caucasus portal (to be fed from the individual country gateways and other sources of information) to give a unified view of investment opportunities in the region as a whole, and facilitate commercial contacts between and among firms of the region.
- Harmonization of Regulatory Frameworks: development of model telecom licenses to increase transparency and competition and model interconnection agreements; harmonization of licensing, interconnection and tariff regimes, in particular to facilitate operations by regional operators. A possibility would be to establish some sort of homologation procedure for trans-border services provided the necessary frequencies are available and can be granted with the view of eventually allowing any one operator licensed in one country to provide service in any of the three South Caucasus nations;
- Unified approach to universal access: A joint approach by all three countries to serving rural and isolated areas would be desirable, which could entail the licensing of special operators to serve rural and isolated areas across borders. This may entail substantive economies of scale, if the geography and economics of some border areas makes it more economically efficient to serve them from a neighboring country rather than from within the country.

ANNEX 2

RECOMMENDATIONS FOR ARMENIA

Public Sector Reform

- There is a need to investigate the feasibility of establishing a credible independent grievance procedure, or ‘ombudsman’ to act as a type of mediator in disputes between private parties and the different public authorities. This recommendation is made in the context of trade facilitation, so refers to the customs and taxation authorities primarily.
- There is a need to prevent rent-seeking behavior on the part of officials, and reform institutional structures that provide opportunities for such behavior. (The study cites the experience of the Armenian Joint Stock Seal Company as a “best practice” which could be adopted and modified by others.)

Roads

- There is a need for institutional strengthening of the Armenian road fund, specifically clarification of the reporting lines and the establishment of an independent board, along standard lines, comprising representatives from the public and private sectors.

Airports

- There is a need to optimize the performance of the new air cargo terminal at Zvartnots airport in Yerevan, and endeavor, if feasible, to facilitate the re-negotiation of the EBRD loan, to allow the facility to lower its rates and generate greater turnover.
- There is an immediate need to try to address the structural problem, pertaining to the availability and cost of aviation fuel at Zvartnots airport.
- There is a need to analyze the need for a larger x-ray scanner at the air cargo terminal at Zvartnots airport, to allow scanning at consignment level, rather than at case level.

Railroads

- There is a need for institutional strengthening in the Freight Railway Company to develop knowledge of its domestic market, and develop capabilities in the areas of market analysis, demand forecasting, pricing and economic and financial appraisal.

Customs

- There is an immediate need for the current procedures, employed by the Armenian Customs service at the border, in respect to inspection and re-sealing to be streamlined if not removed.

Economic/Regulatory/Tax Policy

- There is a need to review the legally supported incentive structure for taxation officials in Armenia, to try to prevent officials from concocting violations, particularly from foreign companies.

- The current requirement for transit traffic to have an escort service to traverse Armenia should be rescinded.
- Assessment is needed for necessary institutional and physical measures and the feasibility in economic, social and environmental terms, of establishing a free trade zone.

Telecommunications

- Support should be given to the Ministry's current effort to review and update the telecommunications law to allow Armenia to face the challenges of the information revolution and to establish an independent regulator. However, with a 15 year restriction on market entry, there is little hope that the country could take advantage of the emerging technologies and business models of the information revolution. Therefore, all efforts should be focused on finding a solution to revisit the exclusivity period balancing the costs and benefits of all possible solutions.

ANNEX 3

RECOMMENDATIONS FOR AZERBAIJAN

Public Sector Reform

- There is a need to investigate the feasibility of establishing a credible independent grievance procedure, or ‘ombudsman’ to act as a type of mediator in disputes between private parties and the different public authorities. This recommendation is made in the context of trade facilitation, so refers to the customs and taxation authorities primarily.
- There is a need to prevent rent-seeking behavior on the part of officials, and reform institutional structures that provide opportunities for such behavior. (the study cites, the experience of the Armenian joint stock seal company as a “best practice” which could be adopted and modified by others.)

Roads

- There is a need for institutional strengthening of the funding sources, and organizations responsible for commissioning and managing road construction and maintenance in Azerbaijan. This would need to clarify responsibilities, identify sustainable source of user-charge based revenue, and establish a road fund, with an independent board, along standard lines, comprising representatives from the public and private sectors.
- There is a need for a road condition survey and maintenance strategy study, which would rank, on a firm economic basis, the maintenance requirements of the network, and ensure the most efficient utilization of limited resources.

Railroads

- There is a need for institutional strengthening in the Azerbaijan Freight Railway Company to develop an action plan to address the environmental problems of the operation, of which one specific problem exists in respect to the refueling points.
- There is a need for institutional strengthening in the Azerbaijan Freight Railway Company to develop knowledge of its domestic market, and develop capabilities in the areas of market analysis, demand forecasting, pricing and economic and financial appraisal.

Shipping and Aviation

- There is a need for institutional strengthening and restructuring of the Caspian Shipping with the objective of optimizing the performance of the ferry fleet, and the inland shipping fleet on the Caspian Sea.
- There is a need for a detailed study to assess the optimal institutional structure of AZAL, the scale and schedule of further privatization, with the implicit objective of the vertical disintegration of the land and air operations.

Customs/Border Crossing

- There is an immediate need to improve the technical and institutional lines of communication between the different public agencies involved in certification and customs clearance.
- There is an immediate need to define the legal base for the establishment of a customs warehouse in Azerbaijan, or more specifically, to confirm the mechanism for the release of the license, to allow interested parties to establish such a facility.
- There is an immediate need to define the legal base for the issue of a license for a customs broker in Azerbaijan.
- There is an immediate need for the publication of a legally established customs code in Azerbaijan, where prospective amendments could be publicized in advance to allow users to adapt to new requirements.

Economic/Regulatory/Tax Policy

- There is an immediate need for more substantive enforcement of the traffic regulations in Azerbaijan, to ensure that 'rogue hauliers' are precluded from plying for trade, and undercutting legal hauliers. One way of denying trade to such operators would be to require all bills of lading to carry the number of a registered freight forwarder.
- Assessment is needed for necessary institutional and physical measures and the feasibility in economic, social and environmental terms, of establishing a free trade zone in Azerbaijan.

Telecommunications

- Restrictions on private ownership should be lifted and the privatization process in the sector launched, possibly with WBG and other IFI assistance. The legal and regulatory framework needs to be substantially updated to reflect a new market structure, including separation of policy, regulation and operation.

ANNEX 4

RECOMMENDATIONS FOR GEORGIA

Public Sector Reform

- There is a need to investigate the feasibility of establishing a credible independent grievance procedure, or ‘ombudsman’ to act as a type of mediator in disputes between private parties and the different public authorities. This recommendation is made in the context of trade facilitation, so refers to the customs and taxation authorities primarily.
- There is a need to prevent rent-seeking behavior on the part of officials, and reform institutional structures that provide opportunities for such behavior. (The study cites, the experience of the Armenian Joint Stock Seal Company as a “best practice” which could be adopted and modified by others.)

Roads

- There is a requirement for institutional strengthening of the Georgian road fund, specifically a clarification of the reporting lines and the establishment of an independent board, along standard lines, comprising representatives from the public and private sectors.

Railroads

- There is a need for institutional strengthening in the Freight Railway Company to develop knowledge of its domestic market, and develop capabilities in the areas of market analysis, demand forecasting, pricing and economic and financial appraisal.

Economic/Tax/Regulatory Policy

- The current requirement for transit traffic across Georgia to have an escort service should be rescinded.
- There is an urgent need to review, with the implicit objective of repealing, Article 64, paragraph D, of the Georgian Tax Code.
- There is an urgent need to review the limits on coverage and required equity contained in the Georgian Law on Insurance, to ensure that the limits do not impede the development of trade.
- Assessment is needed for necessary institutional and physical measures and the feasibility in economic, social and environmental terms, of establishing a free trade zone in Georgia.

Telecommunications

Continued support to liberalization process and privatization of state enterprises, as well as empowerment of the newly established regulator to effectively guard competition and avoid any abuse of dominant position

ANNEX 5

Priority Activities in the Trade/Transport/Telecommunications Sectors after Conflict Resolution

- Customs facilities and border stations should be upgraded, covering both the physical, institutional and electronic infrastructure, to cope with the projected increases in traffic volume. This should cover the provision of all technical equipment necessary to facilitate the work of the station;
- Review the institutional strengthening of the three national railways in the fields of international integration, joint tariffs and international slot availability, undertaken as part of the TRACECA program; Include Armenia in the Xerox/Baku railway tariff agreements.
- Assess the significance of the current cost of credit across the three countries as an impediment to the development of trade, and investigate the potential contribution of micro-credit facilities in the region;
- Rebuilding of major through roads;
- Rebuilding and linking up of railroads
- Creation of a regional inter-governmental network: cooperation between countries in regional trade, transport, environmental, health, educational and security initiatives, among others, would require the existence of an intergovernmental network, which could initially start as an academic network interconnecting universities and research centers between themselves and to the Internet. One possible platform for such a network could be the Traceca fiber optic network of the regional railways, which can eventually be spun off and privatized, creating a regional carrier. The above-mentioned Internet hub could be the seed for such a network.
- Coordinated approach to radio frequency spectrum management; Radio frequency spectrum is not only a scarce resource within countries, it is also a scarce resource at the international level requiring important efforts in international coordination. An important area of support the WB and other donors could provide would be in the development of a regional frequency allocation table, coordinated not only with Russia but also with Turkey and Iran. . This would also be enhanced by interconnection of the respective radio frequency management and monitoring systems.