

## TRANSPORTATION AND ADMINISTRATIVE COSTS: UNEARNED SURPLUS

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**Abstract:** *Trade relations in our region (Armenia, Azerbaijan, Georgia, Iran and Turkey) have interesting peculiarities the most important one being the existence of closed borders.*

*The first indicator, as a barrier to the development of foreign trade in Armenia, is the heavy weight of transportation costs for export and import expenses. The transportation costs in Armenia are more than two times higher than the average international rates and are the highest within the region.*

*Thus the main purpose of this study is to evaluate the unrealized surplus connected to high transportation costs. To assess the unrealized surplus, interviews were conducted in the leading “Apaven” company of Armenia, which implements international cargo transportation and regulates more than 50 percent of imported and exported products in the Armenian market. The interviews aimed to find out how much the supplementary cost constitutes as of now for importing Turkish products into Armenia via the Georgian route.*

*Based on the conducted analysis of literary sources and interview findings, the study concludes that in case of reopening of the Armenian-Turkish border, Armenian importers and exporters will be able to save nearly 10 percent on the cost of cargo transportation as well as two days of transportation, which currently are usually spent on the Georgian route.*

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Countries with no direct access to the sea come across a set of pretty hard problems which include remote geographical placement from international markets, poor infrastructure, non-corresponding trade, not properly regulated customs and institutional environment, as well as some level of dependency on neighboring, transit countries. Thus no direct access to the sea creates a variety of economic, infrastructure and political problems. However, most of these complications of landlocked countries can be overcome or reduced due to proper combination of policies at state and regional levels.<sup>1</sup>

Trade relations in our region (Armenia, Azerbaijan, Georgia, Iran and Turkey) have interesting peculiarities. These five countries exercise a rather heavy trade turnover with the entire world; however, the capacity of inner regional trade turnover is significantly small. It is one of those rare circumstances, when the regional coefficient in trade relations is more active with the outer world, than it is within the region itself. This, of course, is determined by several conflicts, among which, primarily, the existence of closed borders. However, it also speaks of a great potential for inner regional trade-economic relations between these countries in case of elimination of the existing conflicts.

Today, when many speak about the potential reopening of the Armenian-Turkish border and of the necessity to establish friendly political and economic relations, the main argument brought forward is the economic benefit of the reopening of the border. It is evident that the closed condition of the Armenian-Turkish border negatively affects foreign trade in Armenia and seriously harms the social-economic development of the eastern part of Turkey.

The first indicator, as a barrier to the development of foreign trade in Armenia, is the heavy weight of transportation costs within export and import expenses. Transportation costs in Armenia are more than two times higher than the average international costs and are the highest within the region. This can be compared, for instance, with transportation costs in Mongolia, as a country which also does not have direct access to the sea and is ten times more distant from the nearest sea port than Armenia is.<sup>2</sup>

Despite the existing obstacles, a joint study conducted by the prestigious Wall Street Journal and the research center of Heritage Foundation shows that in 2005 Armenia was characterized as a country with “completely free” economy. In any case, it is evident, that the reopening of the Armenian-Turkish border will bring about serious changes altering the export and import structures of Armenia.

It is generally accepted that since the unilateral closure of the Armenian-Turkish border (April 1993), Armenia imports and exports products mainly via the Georgian territory. Today the Georgian Republic is the only path that connects Armenia to the outer world. The majority of trade routes connect Armenia with its principal trade partners only through the Georgian roads. As a result, local exporters and importers face the issue of comparatively high transportation costs, which imposes a serious impediment to trade.

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<sup>1</sup> International Ministerial Conference for Countries with no access to the Sea, Transit development and donor countries. International Financial Institute for Cooperation in Transit Transportation and Development, UNECE Side, Almaty, 2003, 28-29.

<sup>2</sup> Armenia's Transport Policy and WTO Trade System, AEPLAC, May 2004

Due to this Armenia imports and exports lesser volumes than it would have in alternative conditions. At the same time high transportation costs determine the trade structure, as importers and exporters are inclined to do business using products with high value/weight comparability.

Thus, the main purpose of this study is to evaluate the unrealized surplus connected to high transportation costs in Armenia.

**Table 1. Armenia-Turkey trade, 2001-2005**

	2001	2002	2003	2004	2005	Growth compared to 2001	Growth compared to 2001 (%)
Export, volume, tons	2120,6	2804,9	3205,8	12405,4	16212,9	14092,3	664,5
Export, thous US\$	1130,1	1435,8	1154,7	2021,1	2473,5	1343,4	118,8
Import, volume, tons	46175,1	56452,9	64021,0	44804,6	99553,6	53378,5	115,6
Import, thous US\$	34885,4	39667,9	37886,8	46825,7	66928,1	32042,7	91

Source: *Statistical Yearbook of Armenia, 2001-2005*

Figures come to evidence that the blocked condition of the Armenian-Turkish border has significantly harmed exports to Turkey and other countries rather than imports. Particularly, the amount of exports to Turkey is rather small due to limitations put on the Armenian products by the Turkish government. Whereas an enormous amount of Turkish products are imported to Armenia via the Georgia, added that these products are usually re-branded in Georgia and the certificate of origin is falsified. Anyhow, as shown in the Table 1, exports to Turkey from Armenia were 16,2 ths ton in 2005 and 2,4 million US dollars, while imports to Armenia from Turkey have been 99,5 ths ton and 66,9 million USD.

Analyzing this data, we see that exports to Turkey from Armenia have grown by 14 ths tons and 1,3 million US dollars from 2001 to 2005, while imports to Armenia from Turkey have grown for 53,3 ths tons and 32 million USD.

Since the end of 1990s, when the issue of the reopening of the Armenian-Turkish border found its steady place in both political and economic agenda, several studies were conducted, the main purpose of which questioned the following:

- The impact of the reopening of the border on Armenia's foreign trade;
- The influence of changes in the foreign trade volumes of Armenia on the overall economy in Armenia.

Let's examine some of the studies mentioned above, as related to the purpose and approach of this article.

According to the Armenian European Political and Legal Advisory Center (AEPLAC) we can expect decrease in transportation costs, in case of reopening of the border, not only because Armenia will prefer Turkish roads, but also because Georgian transportation companies will be obliged to lower their service charges due to competition. As stated in studies conducted by AEPLAC, the heavy weight of transportation costs, within export and import structures, counts for the 20-25 percent of a product's cost price. Thus, a 4.1 percent decrease can be expected in transportation costs within a short period of time (1 year) as a result of the reopening. This will lead to 4.7 percent increase in imports and 5.9 percent increase in exports. Within mid terms (up to five years), exports to Turkey will rise 17.4 times as compared with 2003 data, while imports from Turkey will go up 2.3 times (AEPLAC, 2005).

In another study, a World Bank economist Yevgeniy Polyakov evaluated the potential for reducing transportation costs while importing Turkish products into Armenia by the main road. He found that the savings will count up for an amount equal to 0.9-1.2mln USD. Complementing the numerical terms, he emphasizes that the availability of a direct connection between Armenia and Turkey will boost the possibility for, predictability and trust in trade turnover. Another option for saving of an amount equal to 1.8-2.0mln USD was calculated in case of using the Turkish seaport. However, here we have to take into account that this study is based on 1997-99 data when Armenia's import and especially export volumes were rather small and that the study did not observe exports from Armenia to Turkey as an option (Polyakov, 2001).

A different study, referenced by a World Bank economist Harry Broadman, finds that the transportation cost for a 20-ton truck from Poti to Yerevan will decrease by 30-35 percent or an amount equal to USD450-750, in case of reopening of the Turkish border (Broadman, 2006).

To assess the unrealized surplus, interviews were conducted in a leading Armenian company, which implements international cargo transportation – “Apaven.” The goal of interviews was to find out how much the supplementary cost constitutes currently for importing Turkish products into Armenia via the Georgian route.

“Apaven” company was established and has been functioning since 1993. The company has more than 13 years of experience in the field of freight forwarding and takes over the transportation of more than 50 percent of imported and exported products in and out of Armenia (mainly by containers). In case of some products it realizes up to 100% transportation (for instance, copper concentrate).

Taking into account that Turkish products are imported through the Georgian route, we inquired with “Apaven”, what changes the so-called “road of life” experienced since the beginning of 1990s. Political changes, or the Roses Revolution, stated positive effects, particularly what related to export of Armenian products and import to Armenia. The pricing policy has not been formally revised and it is changed due to the effect of rising oil prices. The Georgian side has removed the transition declaration, which costs an amount equivalent of USD100-150 per item. In another step, Georgian government annulled the road tax, which constituted even a bigger amount – USD300.

It is necessary to add here, that the bribery instances by the traffic police and other governmental bodies have drastically gone down, which in numerical terms constituted at least a 10-15% of transportation costs. There have been major changes in the Georgian motorcar park, which has considerably improved the quality of current transportation services. It is evident that transition has taken place from the past chaotic and irregular environment to a modern system compliant with economic competition rules.

The polling analysis in “Apaven” shows that the cost of transporting Turkish products via the Turkey-Georgia-Armenia route from Istanbul by a 20 ton truck ranges from USD 3000 to USD 3500. A share of USD 300-400 within that amount range composes the cost of the Georgian route. The transportation takes seven days, two days out of which are spent on the Georgian road. In conclusion, in the case of re-opening of the Armenian-Turkish border, the cost of cargo transportation will drop for nearly 10% (the value of transporting 1 ton will decrease by 15USD), added the saving of two days within the transportation period.

**Table 2. Turkey-Armenia trade, 2003-2005**

	2003	2004	2005	Total
Import, volume, tons	64021.0	83017.8	99553.6	246592,4
Import, thousand US\$	36732.1	44804.6	66928.1	148464,8
Unearned surplus, Import thousand US\$	960,3	1245,2	1493,3	3698,8

Source: *Statistical Yearbook of Armenia, 2003-2005*

Using data provided in the Statistical Yearbook of Armenia (2003-2005), section on Foreign Trade in the Republic of Armenia with Separate Countries based on Group of Products, we have calculated that Armenian imports to Turkey have been 64 thousand ton in 2003, counting for 36,7 mln USD. In 2004, the import has been 83 thousand ton and cost 44,8 mln USD. In 2005, it has been 99,5 thousand ton and 66,9 mln USD.

In case of reopening the Armenian-Turkish border and provided that the cost of transporting a ton would be reduced by USD15 and other conditions remaining the same, the total unrealized surplus in 2003 would be 960 thousand USD, in 2004 – 1,2 mln USD, and in 2005 – 1,4 mln USD. It represents the amount that Armenian consumers annually overpay for the imported Turkish goods, or interpreted another way, as potential direct savings from reduced transportation costs of import after opening of the border.

The main purpose of this study was, thus, to examine the unearned surplus related to decreasing transportation costs for importing from Turkey to Armenia. However, to fully estimate the unearned surplus, the good measure should account for the similar effect of reduced transportation costs on the export as well as the utility lost due to unrealized export potential of Armenia, both for the exporting companies and for the Armenian economy overall. The same can be said about the unearned possibility of using Turkish roads as an outlet to international markets, which will open new possibilities of decreasing transportation prices.

The Government of both Armenia and Turkey should clearly realize the potential benefits from opening of the border and should cooperate with each other on resolving this issue. Armenian policy-makers must elaborate a policy that will help Armenia to benefit from the border opening in the full extent. The sectors that will be affected the most should be identified and an appropriate approach should be applied to those sectors. Everything should be done to avoid a shock for the economy. For instance, if Armenian Government is unsure how the opening of the border and decreased transportation costs will affect the economy, on the initial stages they can impose import tariffs collectively equal to the current unearned surplus, which will compensate for the reduced transportation costs and will keep the prices of imported goods at the same level.

Another alternative is imposing import quotas equal to the current import volumes. These import barriers will be reduced gradually, sector by sector, thus minimizing the negative impact. This will help to avoid abrupt structural changes in the economy and will help Armenian producers to adjust to the new economic environment. Even though initially Armenian consumers will still continue paying higher, there is a difference in that collected import duties will supplement Government Budget and can be spent for the special Adjustment Program aimed at helping affected sectors of economy to increase their competitiveness.

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