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**COVID-19 and Economic Recovery Potential in CAREC Region**

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# Part 1: Digital CAREC and post-COVID-19 economic recovery

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## Note

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# Digital Transformation and COVID-19 in the CAREC Region: A Computational General Equilibrium Model

- This study introduces a computable general equilibrium (CGE) -based Global Trade Analysis Project (GTAP) model to examine the role of digital transformation in the CAREC region.
- The results indicate that boosting IT and increasing the employment of skilled labor can reduce the economic and social costs associated with COVID-19 in the region.
- The simulation results show that boosting IT increases the production output in most of the sectors of all the countries under analysis. The analysis shows that the real gross domestic product (GDP) of all the CAREC countries increases. The highest growth is witnessed in the People's Republic of China (PRC), Georgia, and Pakistan, where the growth rates of real GDP increase by 2.19%, 2.15%, and 2.14%, respectively.
- All the CAREC countries report positive trade balances except the Kyrgyz Republic and Tajikistan, which report moderate losses in their trade balances.
- The results further show that the direct health cost is the highest in Pakistan and Kazakhstan compared to other countries. A comparison of direct health costs with the gains from higher welfare levels indicates that accelerated adoption of IT can effectively offset the direct economic cost of COVID-19 in the short run.

# Policy Recommendations

- Smaller CAREC economies need to upgrade their IT infrastructure, as promoting the use of IT can offset the direct economic cost of COVID-19 in the short run. Such activities will generate IT cluster zones, which will boost the IT industry and facilitate the growth of skilled labor.
- In the long run, there is a need to invest more in the health sector to ensure the availability of required vaccination infrastructure at the micro level.
- Lower tariff rates in the CAREC region will promote more regional trade, coupled with a higher regional welfare level.

# E-Commerce Taxation in Central Asia: The Current State and Opportunities for Reform

- This paper looks at the current state of e-commerce taxation in broad economic contexts. The goal is to develop tax policy proposals for reforms and regional cooperation.
- The analysis shows that the digital transformation of business is an important, yet still underdeveloped in CA economies. This is primarily because of that e-commerce business development is on the agenda of policymakers in some states, but it is not yet a daily business and consumer reality.
- The analysis finds a large gap between Kazakhstan and the other CAREC members and provides details on the extent of this gap. This gap can be observed at the level of tax administration capacity, in the volume of trade in digitally deliverable services, and in the development of e-commerce infrastructure.
- The CA e-commerce landscape is also dissimilar among the four states examined here. Kazakhstan is a regional leader, while Uzbekistan is striving to catch up. Uzbekistan's tax policy makers are especially active in regulating e-commerce by providing significant tax benefits both for SMEs and for the largest businesses. All these countries are trying to ensure a level playing field by taxing foreign-provided digital services in both the B2B and the B2C sector

# Policy Recommendations

- Cooperation between digital platforms and tax authorities can be a useful and appropriate policy tool.
- There is need to create simple and clear tax conditions for the leading foreign and local e-commerce platforms operating in the SMEs' markets.
- As digital business transformation evolves worldwide, it is appropriate for CA countries to have their own regional position on taxing the profits of Big Data consumer-facing MNEs with virtual economic presence there.
- Finally, tax systems are not only about collecting taxes but also about helping businesses in difficult times. Therefore, tax systems are an inseparable part of the broader fiscal policy. This was especially noticeable during the COVID-19 crisis when tax administrations played a crucial role in channeling government support funds to the most vulnerable businesses. Therefore, such an approach could also be used in the analyzed countries for channeling government support to the most vulnerable businesses.

# Financial Inclusion in the CAREC Region: Promoting Fintech to Meet Underserved Needs in Trade Finance

- This paper examines the challenge of trade finance shortfall in the context of the Central Asia Regional Economic Cooperation (CAREC) region, where 2 in 5 of the respondent micro and small firms saw their trade finance applications partially or totally rejected, with many of the firms unable to seek alternative finance.
- Applying the Heckman two-step correction model to analyze a cross-section of firms in various waves of the Asian Development Bank's Trade Finance Gaps, Growth, and Jobs survey, the study validates that smaller firms experience higher incidence of trade finance rejections relative to larger firms, owing largely to their unfavorable financial health and history.
- Interestingly, results suggest the potential of fintech in reducing the unduly high incidence of trade finance rejections among smaller firms, thus advancing financial inclusion.
- The paper maps the financial ecosystem in CAREC countries and explores the potential opportunities and limitations of fintech adoption and entry points for intraregional cooperation.



# Policy Recommendations

- In the short to medium term, CAREC member countries should focus on strengthening the fundamental growth pillars of fintech.
- The region needs to further bolster the ICT and digital infrastructures while ensuring regulatory quality involving cybersecurity and other technical vulnerabilities, data governance, and privacy protection.
- Specific to trade finance, the region should consider efforts to lower transaction costs steering away from conventional trade clearing procedures. Facilitating greater use of fintech in trade and supply chain finance is in line with ongoing efforts to step up support for the development of e-commerce in the region.
- Learning from country-specific lessons, the CAREC region's fintech adoption and advancement should be based on efficient financial structures, effective regulatory frameworks, and the needed capabilities to advance inclusive trade and finance.

Thank you