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ECONOMIC IMPACT OF THE EURASIAN ECONOMIC UNION ON CENTRAL ASIA

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KEY POINTS

• Although currently the Eurasian Economic Union (EAEU) covers four economies, the vast territorial and neighborhood span of the EAEU makes it a strong supranational organization which in the long term can be similar to the European Union;

• In Kazakhstan, the EAEU integration is interpreted by policymakers as a purely economic process whereas Russia considers integration as a significant geopolitical strategy, therefore the EAEU’s formation maybe seen as Russian political power imposed on other member countries;

• In three years of the Customs Union (CU), Kazakhstan is the member state that has benefited the least, with Belarus and Russia faring better;

• Integration is nevertheless necessary because of the nature of economic dependence and geopolitical configurations in the current era and may serve as the “legalization” of economic dependence on Russia for other states of Central Asia such as Kyrgyzstan and Tajikistan.
I. EURASIAN INTEGRATION

The agreement to launch the Eurasian Economic Union (EAEU) was signed in May, 20141 by Kazakhstan, Belarus and the Russian Federation. Initially, the idea of Eurasian Integration was suggested twenty years ago by the president of Kazakhstan, Nursultan Nazarbayev.2 Nazarbayev’s suggestion was underpinned by the high economic interdependence of the markets of post-Soviet states at that time. Later the idea developed further with the formation of the Eurasian Economic Community in 2000, which aimed at providing a common legal framework for energy markets and free movement of labor.

The next step towards integration was the formation of the CU in 2010 between Russia, Kazakhstan and Belarus. The CU achieved the elimination of tariff barriers on trade between member countries and the harmonization of regulations for trade partners outside of the CU. The EAEU is the logical continuation of the CU, comprising additional steps towards economic integration through unification of labor and trade legislation as well as the harmonization of the legal framework in other areas.

While Kazakhstani authorities interpret integration as a decision made exclusively for the economic benefits of member countries, the union undoubtedly complements the geopolitical ambitions of Russia. According to Russian President Vladimir Putin, the union will grow to be comparable with main regional organizations such as the

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European Union, NAFTA, and ASEAN. Therefore, for many, the creation of the CU between Russia, Kazakhstan and Belarus in 2010, and its evolution into the EAEU implies an uptick in the political influence the Russian Federation will bring to bear on other member states, and is thus potentially the geopolitical heir of the USSR.

Although at this point it is unlikely that the western post-Soviet republics will become part of the EAEU, the union’s borders might expand through Central Asia instead. Kazakhstan as the region’s largest economy is already a founding member of the CU and the EAEU. Kyrgyzstan has agreed to enter the structure, while Tajikistan is another potential member of the union. Turkmenistan, which positions itself as a neutral state, can be disregarded in discussions of membership.

Given this trend and in aiming to find the true reasons for and beneficiaries of Eurasian integration, we raise the following question:

“What are the economic advantages of being an EAEU member for states of Central Asia?”

This study provides descriptive analysis of the potential economic impact of forming the EAEU on Central Asian economies with an emphasis on Kazakhstan, Tajikistan and Kyrgyzstan.

1.1 Kazakhstan

As a member of the EAEU, the economy of Kazakhstan remains the most globally integrated country in Central Asia. The union offers a number of benefits as well as challenges for the economy. Since Kazakhstan is a land-locked country, the issue of economic integration is particularly important in improving the country’s role in international trade. Joining the EAEU will grant more favorable conditions in terms of accessing the Russian and European transport infrastructure.
for Kazakhstani business, and thus will reduce the transport costs of foreign trade. Moreover, Kazakhstan will enhance its negotiating position with third countries on the world market as a member of an economic bloc. For instance, a series of talks have already been conducted by the CU with major economic blocs such as the European Union and the OECD, along with India, Vietnam and other countries.

It should be noted that the benefits associated with the entry of Kazakhstan into the EAEU are mainly oriented towards consumers. Firstly, due to inclusion of certain countries which were not part of the CU (Armenia, Kyrgyzstan, possibly Tajikistan and others), the possibility of a wider selection of goods will grow. Secondly, the expansion of the market will increase competition between companies, which should lead to better quality products at reasonable prices. Thirdly, the formation of a common labor market and the creation of joint ventures with partners within the EAEU will reduce unemployment and is expected to increase welfare. Also, according to the Minister of Healthcare and Social Development, since Russia and Belarus have higher salary standards than in Kazakhstan, experts expect that local salaries will also grow in order to prevent brain drain from Kazakhstan.4

However, it is important to mention that in the first three years of the CU, Kazakhstan benefited less than both Belarus and Russia from membership. For example, according to the research results of the European Bank for Reconstruction and Development (EBRD), as a result of membership in the CU, Kazakhstan experienced significant upward changes to tariff lines on products from other Central Asian states, with tariffs sometimes levied by 50 per cent. Moreover, membership entailed an increase in non-tariff barriers, too. Specifically, clearance time for trucks from Central Asian

countries outside the CU has increased by 47 per cent.\textsuperscript{5}

Graph-1, Distribution of changes in tariffs on Customs Union’s introduction – Kazakhstan
% of affected tariff lines

Graph-2, Distribution of changes in tariffs on Customs Union’s introduction – Belarus
% of affected tariff lines

Graph-3, Distribution of changes in tariffs on Customs Union’s introduction – Russia
% of affected tariff lines

The importance of trade to the economy of Kazakhstan is clear; trade constitutes 31 per cent of the services sector, whereas in countries with a more developed domestic market it comprises 15-20 per cent on average. A large part of the population in Kazakhstan gets income from trading goods and services, therefore in social terms and based on the experience of the CU, the integration process may harm vulnerable layers of society because of deteriorating trade conditions with important partners which did not join the EAEU.

The EAEU was expected to be a possibility for Kazakhstan to attract foreign investors from member states into Kazakhstan. Harmonization of laws, elimination of barriers to market access may have a positive contribution to growth of foreign direct investment (FDI) within the EAEU. However, if one looks back in the trends during the period of the CU, the share of Belarus and Russia in total FDI in Kazakhstan remains less than 5 per cent, whereas Belarus, in contrast, gains about 70 per cent of its FDI from Russia. Moreover, significant growth in investment in Kazakhstan from other members of the CU has not been observed in recent years. Because the integration process has not contributed to investment attraction in Kazakhstan, the need to stimulate investment is pressing.

Another equally important and positive factor relating to entry into the EAEU is the potential for gradual improvement of state institutions. As a rule, close cooperation of governmental institutions between two or more countries leads to a gradual improvement in human resources and the quality of work state institutions produce. For example, the integration of 15 Caribbean countries in 1973 led to significant advances in terms of the effectiveness of institutions rather than in trade.6 There is a possibility that such institutional improvements will take place in Kazakhstan, Russia and Belarus. Currently, as the World Bank’s Governance Indicators demonstrate, Russia shows the lowest control of corruption (16 from 100); whereas Belarus indicates the worst regulatory quality among EAEU

member states (18 from 100).

Finally, Russia’s annexation of Crimea and its involvement in Eastern Ukraine conflict as well as recent geopolitical scenarios connected to that invasion may unfavorably influence the economy of Kazakhstan as a member of the EAEU. The economic stagnation of Russia, devaluation of the Russian Ruble since March 2014 as well as the Russian Central Bank’s gradual turn towards a floating exchange rate policy has already reflected on the political and economic image of Russia. The World Bank and the International Monetary Fund (IMF) have already stated that economic sanctions against Russia will have a negative effect on economic growth, which will consequently impact Kazakhstan’s economy.7

I.II Kyrgyzstan

Kyrgyzstan became the first Central Asian country to join the World Trade Organization (WTO) in 1998. Although Kyrgyzstan is considerably less developed than other member states, and there are a number of economic risks to be aware of, the country is committed to join the EAEU in 2015 from May, 2015.8 Therefore, integration may harm the emerging private sector and have a detrimental effect on the Kyrgyz economy. Considering the importance of the Chinese economy not only in terms of trade, but also in providing cheap products to Kyrgyzstani consumers, there are serious questions about the effectiveness of full EAEU membership for Kyrgyzstan.

Kyrgyzstan functions as the biggest regional re-export hub for Chinese products heading to Kazakhstan and the Russian Federation. This hub located in Bishkek is a significant component of the GDP of Kyrgyzstan which provides 50 thousand workplaces and contributes to emerging garment industry employing 150 thousand workers among the whole

population of 5.8 million.⁹ Obviously, joining the union which hints increase in tariffs and rising unemployment is going to be costly for Kyrgyzstan. As a buffer for a lower social class, Andrei Slepnev, Minister for Trade of the Eurasian Economic Commission (EEC), has promised to provide a regime where Chinese imports will be saved in amount necessary for domestic demand in Kyrgyzstan. But, what imposes a doubt on the given promise is that the minister did not provide any specific mechanisms and schedules of the regime.¹⁰

According to the Statistical Agency of Kyrgyzstan, in January-May of 2014, the overall share of the EAEU in the foreign trade of Kyrgyzstan comprised 40.5 per cent. Specifically, EAEU countries receive 31 per cent of Kyrgyzstan’s exports; where in the most part (23 per cent) are received by Kazakhstan (Graph-4). Also, 43.5 per cent of Kyrgyz imports come from the EAEU, wherein the dominant part (31 per cent) comes from Russia.¹¹ As we can observe, the EAEU states are no less significant for the Kyrgyz economy than China.

Entering the EAEU may be advantageous for Kyrgyzstan in terms of regulating issues related to migration, an important factor due to its significant dependence on remittances. Currently, remittances from Russia are an equivalent to 28.6 per cent of GDP. Because of similar culture and the broad influence of the Russian language in society due to historical factors, 92 per cent of Kyrgyzstan’s migrant laborers migrate to Russia and 8 per cent work in Kazakhstan. Migration is explained by existing unemployment in Kyrgyzstan and Kazakhstan and Russia’s demand for cheap labor. Generally, migration has a positive impact on the economy of Kyrgyzstan. A survey by the Eurasian


Development Bank (EDB) revealed that “over 40 per cent of migrant workers send up to half of their salary back home to their native country, which is between 200 to 500 dollars a month. These funds have mainly been used for consumption, but a trend towards investment in the development of small businesses is growing, particularly in the retail sector”. Moreover, research shows that only six per cent of migrants in Russia and nine per cent of migrants in Kazakhstan intend to stay there permanently. Instead, migrants mainly wish to return to their families and also to use competencies and skills learned abroad. In this regard, integration into the EAEU is a solution to the problem of illegal migration by providing better conditions for migrants such as equal rights, healthcare and income.

Graph-4, the main trade partners of Kyrgyzstan: Russia and Kazakhstan play a significant role in the foreign trade of Kyrgyzstan

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I.III Tajikistan

Tajikistan is currently assessing the benefits and disadvantages of joining the EAEU. The country is reliant on Russia in terms of remittances. It is estimated that there are almost one million Tajik citizens registered in Russia. According to the World Bank, remittances in 2014 equate to 48 per cent of the GDP of Tajikistan, making it the most remittance-dependent country in the world. During the last ten years remittances to Tajikistan comprised 19 billion USD. Remittances have been during this period, peaking in 2012.\(^\text{15}\) The country’s reliance on Russia entails that any legislative change restricting labor movement with countries beyond the EAEU may have significant negative consequences for Tajikistan’s macro-economic situation. On the other hand, joining the EAEU may facilitate easing the regulations of Tajik migrants in the member countries including Russia.

Another aspect to mention is that Russia is one of the main investment and trade partners of Tajikistan. For instance, in 2013 Russia’s FDI in Tajikistan comprised 1.2 billion dollars, constituting half of all investments.\(^\text{16}\) In terms of trade, 35 per cent of Tajikistani imports come from Russia, 24 per cent from Kazakhstan and 23 per cent from China whereas the major part of exports from Tajikistan are sent to Turkey (48 per cent) with less significant share to Russia (12 per cent). (Graph-5)

A rational logic may lead the country to join the EAEU due to its dependence on remittances from Russia and significant role of Russian investments and trade in the economy. However, there is a need for scrupulous evaluation of the economic impact of joining the EAEU for Tajikistan. The country may find itself in a trap by trying to solve its economic weakness through deepening the integration into the EAEU and consequently growing its dependence on deteriorating economy of Russia. Indeed, the recent economic situation which includes free fall of the


ruled, zero economic growth, intensive outflow of capital and negative outlook in Russia may lead to unpredictable negative consequences, if the country deepens its integration with Russia. Moreover, compared to its Central Asian counterpart such as Kyrgyzstan, Tajikistan has alternatives in attracting investment and fostering foreign trade. For example, FDI from China has been considerably growing in recent years and promises to reach 6 billion USD in upcoming years. In terms of trade, Turkey outreaches Russia 4 times in accepting Tajikistani exports (Graph-5).

Graph-5, Share of exports/imports from/to Tajikistan by major countries of destination in 2013


II. CONCLUSIONS/RECOMMENDATIONS

We recall the significance of the EAEU in territorial as well as in economic terms during a period of growing geopolitical risks and high interdependence between the economies mentioned. It can be assumed that further integration of Kazakhstan into the EAEU will improve the competitive advantages of the country by raising requirements for the quality of products, expanding the overall market, as well as improving the negotiating position of Kazakhstan. However, Kazakhstan has thus far been the one member of the bloc that has benefited the least in economic terms. Consequently, the country faces several important challenges, which need to be solved: namely finding a path to mitigate both the deteriorated trade conditions due to increased tariffs and geo-economic and geopolitical risks connected to Russia’s leadership of the bloc.

Overall, integration may provide the basis for the “legalization” of economic dependence on Russia for other Central Asian members, such as Kyrgyzstan and Tajikistan. Kyrgyzstan will experience economic difficulties through trade flows as a member of the EAEU. Moreover, adverse social effects in Kyrgyzstan due to tariff changes and lower imports from China can be expected. In the medium term, reshaping the economy from being a hub for re-exports from China towards a manufacturing and service-oriented country is preferable. Also, as a member of the EAEU, the Kyrgyz Republic will benefit from greater economic security for its migrants, who Russia is likely to punish in the event of non-accession. Tajikistan may consider joining the union as optimal choice: since this decision should lead to greater FDI from Russia as well as benefits from increased labor mobility within the bloc. Nevertheless, joining the EAEU with economically deteriorating Russian economy means to carry significant economic and political risks for Tajikistan in the future.
III. REFERENCES


