Agenda for the EEU Economy

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The Eurasian Economic Union (EEU) is a young integration association, that was formed to help participating countries unlock their economic potential, boost economic ties within the region, and create conditions for improving the countries’ global competitiveness. The core of this integration project is the creation of a single market for goods, services, capital, and labor.

After a number of false starts in the 1990s and 2000s, the emergence of the EEU marks a major step forward. Numerous challenges lie ahead. Global projects are always hard to get off the ground. However, despite a number of outstanding issues, the idea of deep economic integration in Eurasia is becoming a reality.

What needs to be done for the EEU to have the most positive impact possible? In our opinion, the agenda for the next ten years should include the following steps:

- completing the formation of a single market for goods and services by removing existing exemptions;
- canceling as far as possible and/or unifying non-tariff barriers within the union;
- coordinating macroeconomic policy, including monetary and financial matters, thereby preventing the economic union’s “sprawl;”
- creating a network of free-trade areas and free-trade agreements, including with two key trade and investment partners, the EU and China.

Implementing these steps, as well as more specific initiatives related to the infrastructure development, industrial policy, agriculture, the labor market, a unified pension space, scientific and educational cooperation, etc., would maximize the effect of Eurasian integration.

Before providing details on these objectives for the EEU, let’s start by briefly highlighting how Eurasian integration and its institutions have evolved over time.

**The evolution of Eurasian institutions**

The start of this major international project dates back to March 1994, when President Nursultan Nazarbayev of Kazakhstan delivered a speech at Moscow State University. He discussed creating a Eurasian Union with a focus on the economy, a revolutionary integration paradigm for that time.
There is a saying, “In Russia you have to live a long life,” which applies perfectly to regional integration in Eurasia, as it took 20 years and a number of false starts to realize this vision.

During this time, the mechanisms embedded in the Commonwealth of Independent States (CIS) kept multiple potentially devastating disintegration forces at bay. Industry councils on transportation and electric power played a special role by preserving technological uniformity and the power grids. That said, it is clear that the CIS was unable to move beyond the task of managing a “civilized divorce” for a number of objective reasons.

In 1995, Belarus, Kazakhstan and Russia, which now constitute the core of the EEU, signed the Customs Union Treaty. The document envisaged removing barriers to free cooperation between the countries’ commercial enterprises, promoting free trade, and fair competition. This was the first false start.

In 2000, five countries established the Eurasian Economic Community (EEC).

In 2003, the presidents of Belarus, Kazakhstan, Russia, and Ukraine signed the Treaty of the Common Economic Space. However, Ukraine’s Orange Revolution in 2004 put an end to this initiative, to the lasting regret of many involved. After all, Ukraine’s participation in Eurasian integration would make good economic sense. This was the second false start.

In October 2007, Russia, Belarus and Kazakhstan signed the Treaty on the Creation of the Common Customs Territory and Establishment of the Customs Union (CU). An action plan has been adopted to provide for the free movement of goods among the members, facilitate trade with third countries, and promote economic integration.

Few believed this next attempt would be any more successful, but when the two-year plan came to an end, Alexander Lukashenko of Belarus, Dmitry Medvedev of Russia and Nursultan Nazarbayev of Kazakhstan met in Almaty on December 19, 2009, to sign a statement on the establishment of the Customs Union. On January 1, 2010, a single customs tariff took effect. This outcome was due largely to the global economic crisis, which pushed the three countries closer together.

The Customs Union of Belarus, Russia and Kazakhstan was up and running by 2011. A single customs territory was created and a single customs tariff enacted.


2 There is a standard theoretical misconception that crises tend to be an obstacle to integration, since protectionist tendencies usually reemerge in these circumstances. However, we argue that economic crises can drive integration processes, but only if countries share close ties and there are no real alternatives. See: E.Vinokurov, A. Libman, (2014) “Do Economic Crises Impede or Advance Regional Economic Integration in the Post-Soviet Space?”, Post-Communist Economies, Vol. 26 (3), 341–358.
On January 1, 2012, 17 agreements serving as a platform for the Single Economic Space (SES) took effect. They set out regulations on a number of key economic cooperation issues for the three countries, from coordinating macroeconomic policy to labor migration.

Finally, the Treaty on the Eurasian Economic Union came into force on January 1, 2015. Armenia joined the integration project on January 2, 2015, followed by the Kyrgyz Republic in May 2015.

**The EEU institutions**

The EEU “family” of institutions is now in place. The Supreme Eurasian Economic Council consists of the heads of the member-states and oversees the key issues related to the union’s operation and strategy, and the advancement and future prospects of integration. The heads of government of the member-states are represented in the Eurasian Intergovernmental Council, which is vested with authority to work in 10 areas, including enacting and overseeing implementation of the EEU Treaty and approving draft budgets. The Eurasian Economic Commission (EEC), the single supranational institution in charge of regulating and promoting integration, is fully operational. All in all, 140 powers were transferred to the supranational level by the member-states.

Other key institutions of the EEU are as follows.

The Court of the Eurasian Economic Union, which is a specialized body with jurisdiction over disputes related to the implementation of international treaties within the union and decisions of EEU institutions. For instance, its rulings regarding the Single Customs Tariff have direct effect.

The financial mechanisms of Eurasian integration are operated by the Eurasian Development Bank (EDB) and the Eurasian Fund for Stabilization and Development (EFSD). With six member-states, $1.6bn in capital, and a $5bn investment portfolio, the EDB is a prominent international financial institution. It carries out priority projects aimed at expanding mutual trade and cross-border investment. With $8.5bn in capital and six participating countries, EFSD is a key tool for dealing with crises and stabilizing the region.

The 680-page Treaty on the Eurasian Economic Union is the core legal document of the EEU. It consists of a 100-page Treaty and annexes.3

All in all, a regional integration structure has been established for a market of about 180 million people with an aggregate GDP of $2.2 trillion. Russia and Kazakhstan are the two biggest economies of the union (Table 1).

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Table 1. Socioeconomic development indicators for EEU countries, 2014

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Armenia</th>
<th>Belarus</th>
<th>Kazakhstan*</th>
<th>Kyrgyz Republic**</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Nominal, $bn</td>
<td>10.3</td>
<td>76.1</td>
<td>212.3</td>
<td>7.4</td>
<td>1,857.5</td>
</tr>
<tr>
<td>GDP PPP, $bn</td>
<td>24.3</td>
<td>172.0</td>
<td>418.5</td>
<td>19.2</td>
<td>3,564.5</td>
</tr>
<tr>
<td>GDP Nominal per capita, $</td>
<td>3,121.2</td>
<td>8,041.7</td>
<td>12,183.5</td>
<td>1,298.6</td>
<td>12,926.0</td>
</tr>
<tr>
<td>GDP Real, average growth rate for 2010-2014, %</td>
<td>4.2</td>
<td>3.5</td>
<td>6.0</td>
<td>3.7</td>
<td>2.8</td>
</tr>
<tr>
<td>Population, mn</td>
<td>3.3</td>
<td>9.5</td>
<td>17.4</td>
<td>5.7</td>
<td>143.7</td>
</tr>
<tr>
<td>Foreign trade, $bn</td>
<td>5.9</td>
<td>77.2</td>
<td>105.0</td>
<td>7.4</td>
<td>805.8</td>
</tr>
</tbody>
</table>

* Foreign trade has been calculated based on EEC data on trade with third countries and mutual trade.
** Based on data from the Kyrgyz Republic’s balance sheet.
Source: IMF, national statistics institutions, EEC, EDB calculations.

Eurasian integration is already yielding positive results. For instance, according to the Monitoring of Mutual CIS Investments by EDB’s Center for Integration Studies, investment between EEU countries remains stable at $25.1bn, while mutual investment within the CIS registered a significant decline.4

Eurasian integration also has popular support in the member-countries. According to a public opinion poll carried out by the Center for Integration Studies as part of the EDB Integration Barometer project, approval of the Customs Union remains at a comfortable 65%-78%.5

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Key elements of the agenda in coming years

Eliminating the remaining exemptions from the single market of goods and services

The future of Eurasian integration is contingent upon the success of bottom-up integration, i.e., increased mutual trade, cross-border investment, and orderly labor migration. This calls for the enactment of uniform rules of the game within the EEU economy. Looking ahead to 2025, the main objective should be to expand the single market to a level close to 100% of the domestic markets of participating countries.

The EEU member-states will have to modernize their economies and promote cooperation between them by phasing out exemptions from the single market. For example, the parties agreed to create a single market for pharmaceuticals and other medicines by January 1, 2016.

Preparations for the creation of a single electric power market are also getting underway. Once the EEC approves the concept of a single electric power market, an international treaty will be drafted to this effect so that the market becomes operational by 2019, as planned.

The issue of setting up a financial super-regulator within the EEU by 2022 is also on the table. It could be created as a supranational financial institution in charge of devising uniform rules for financial markets within the union, regulation, and oversight.

A single market for oil, gas and related products is expected to be created by 2025, which is quite a long time from now. However, this long timeframe is deliberate and can be explained by the fact that the oil and gas sector is vital for the budgets of the participating countries.

Removing non-tariff barriers and unifying tariffs

One of the key issues on the EEU’s agenda for the next several years is unifying and removing non-tariff barriers to trade in goods and services. Non-tariff barriers act as a drag on trade within the EEU, undermining the efficiency of the single market. They are especially harmful to cooperation in technology-related segments.

EDB’s Center for Integration Studies has carried out the first-ever large-scale research project to evaluate how non-tariff barriers affect trade within the EEU and develop recommendations on removing them. Corporate surveys in Belarus, Kazakhstan and Russia show that losses from non-
tariff barriers account for 15%-30% of exports. In other words, 15-30 cents are being lost per every dollar of exports within the EEU.6

Non-tariff barriers can be divided into two groups. The first includes non-tariff barriers such as sanitation and phytosanitary measures, technical barriers, quotas, bans and quantitative controls. The second group consists of price controls and competition-related initiatives, such as the existence of special importers, restrictions on sales and public procurement, and subsidies. The second group is often referred to as “sand in the gears,” since it does nothing but hamper the movement of goods and could be fully phased out. Experts from the Center for Integration Studies have come to the conclusion that these non-tariff barriers are the most detrimental to trade. Consequently, removing this “sand in the gears” of mutual trade should become a priority.

The research project by the Center for Integration Studies also showed that Belarus stands to gain the most from the removal of non-tariff barriers in the medium term: its real GDP could climb 2.8%, and cumulative per capita GDP could increase 7.3%. In Kazakhstan, per capita GDP would add 1.3%, and real GDP could notch up 0.7%. The influence on Russia would be less pronounced, with cumulative per capita GDP up 0.5% and a 0.2% uptick in real GDP. This is due to the size of the Russian economy, as well as the fact that trade within the EEU accounts for a smaller portion of its overall trade compared to other member states.

The research has found that the reduction of non-tariff barriers will most benefit machine and equipment makers who have the highest non-tariff barriers. Pulp and paper mills, food companies, leather, shoe, rubber and plastic product makers are also expected to gain substantial advantages.

Furthermore, the issue of high non-tariff costs is also relevant for exporters of chemical products to Belarus and Russia, wood processing products to Kazakhstan and Russia, agriculture products to Belarus, as well as electrical equipment, electric and optical equipment to Kazakhstan.

**Real macroeconomic, monetary and financial coordination**

A harmonized macroeconomic policy is vital for EEU countries. A mechanism of this kind would provide for macroeconomic stability. Markets would run on the same principles, sharing the same indicators to make them more sustainable and further promote integration.

Providing for extensive coordination of macroeconomic monetary and fiscal policy is vital for the EEU’s future. Similar and moderate inflation rates, converging price of financial resources and their reciprocal availability, converging risk premiums, stable and sustainable growth rates, debt stability, tax and budget balances (Table 2) – all these improvements have to be made within the EEU. The

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Treaty sets out three criteria that must be met: public debt to GDP ratio, inflation rate, and budget deficit. But how to achieve compliance with these conditions of the participating countries? This is a question that needs to be answered.

Table 2. Key macroeconomic indicators of sustainable economic development of EEU member-states

<table>
<thead>
<tr>
<th>VALUE OF MACROECONOMIC INDICATORS</th>
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<tr>
<td>Annual consolidated public sector budget deficit below 3% of GDP</td>
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Source: EEU: Treaty of the EEU.

Tax and budget coordination is one of the key prerequisites for a monetary union’s success. Without it, all efforts to create the union will have been in vain.

The examples of Greece and a number of other Southern Europe countries are instructive. When the Eurozone was created, investors viewed them as low-risk borrowers. However, without fiscal policy coordination, the growth of debt and public spending got out of hand, which eventually led investors to revisit risk premiums and brought about severe debt crises. Consequently, a monetary union is only about controlling budget deficits and public debt levels.

Should a single currency be introduced? There has been much talk recently about creating a single currency and a central bank. In our opinion, at the current stage this discussion is unjustified and even counterproductive.

The main mid-term objective of efforts to coordinate monetary and financial policy should be to reduce the volatility of mutual currency rates within the EEU and to prevent their “divergence,” which threatens the stability of the single economic space. This could help reduce trade losses, expand trade, as well as pave the way to long-term mutual investment. Predictability and stability on forex markets are of paramount importance for investors, especially for small countries.

Moreover, coordinating monetary and financial policy has obvious advantages in addition to being a justified and logical step in developing and strengthening the EEU. Developing uniform rules for the forex market, payments and settlement transactions, as well as coordinating monetary and fiscal policies, could benefit member-countries in a number of ways, such as:
• expanded mutual trade as a result of lower transaction costs and forex volatility;
• positive impact on the financial market in general and investment with lower investment costs and risks, leading to an increase in mutual investment;
• lower borrowing costs due to stable inflation and interest rates, which is particularly important for smaller EEU economies. A currency union promises stability for countries with higher inflation.

The currency crisis that hit Russia in December 2014 is often used as an argument against a closer monetary and financial relationship. Not only do we not share this view, but we argue the exact opposite. Data for the last four quarters show that the other EEU currencies are already highly dependent on the ruble. Sooner or later, they inevitably follow the ruble in its fluctuations in one way or another. To prevent short-term imbalances, this mechanism should be transparent and regulated.

Here’s an example.
Russia-bound exports from Belarus dropped 39% in January 2015, while overall exports were down 25%. Although this was caused by a number of reasons, forex-related issues, i.e., Belarusian products becoming less competitive on the Russian market, had a significant impact. In the first quarter of 2015, the Belarusian ruble lost 51% against the dollar year-on-year, while the Russian ruble lost 80% of its value, compared to a 9% and 16% decline for Kazakhstan’s tenge and Armenia’s dram, respectively.

For Belarus, coordination of monetary policy should take place against the background of a much higher inflation rate. This could lead to current account problems. Preliminary calculations of such a scenario show that over a period of 4 years, the accumulated current account deficit could reach 7%-8% of GDP above the baseline scenario. Consequently, the country would have to find external sources of funding.

EEU countries will also have to answer a number of other questions related to financial integration:
• Banking liberalization, including access to the banking system for foreign players, foreign banks opening branches, and removing capital controls.
• Leveling the playing field for capital account transactions.
• Liberalizing access to the securities market in terms of brokerage services, including unhindered floating and circulation of securities of EEU issuers.
• Liberalizing access to the securities market for depositaries.

Creating a network of free trade areas and entering into trade and economic cooperation agreements within the Eurasian Union

A broad range of issues related to trade and economic cooperation should be addressed. In fact, global trade is undergoing tectonic shifts, and often not to the EEU’s advantage. It has to be
acknowledged that for now, the EEU with its $2.2 trillion GDP and 182 million people (and a working-age population of 92.9 million) is not self-sufficient. It accounts for just 3.2% of global GDP. Consequently, any attempt to build Fortress Eurasia would be suicidal.

What are the possible solutions, given the current crisis in relations with the West?

The first solution would be to create a network of free trade areas. The first agreement, with Vietnam, was signed in May 2015. Similar deals with Egypt, India, and Israel are in the pipeline. Other potential partners could be South Korea, Chile, South Africa, Iran, etc.

The second option would be to take talks with EEU’s major trade and economic partners, the EU and China, to a new level. In this case, the best approach for the EEU could be articulated in the spirit of Chinese big-character posters: “Standing on both legs.” In other words, the Eurasian Union cannot afford to rely on just one partner.

Some progress has been made in this area. The EEU and China have started talks on a trade and economic cooperation agreement. The EEU’s participation in China’s new strategic project, the Silk Road Economic Belt, is widely discussed. There is no doubt that mutually beneficial cooperation between the EEU and China should add momentum to regional development, as well as facilitate transport, energy and financial cooperation in Central Asia, Siberia, and Russia’s Far East.

Interest in economic cooperation and integration between the EU and the EEU is also on the rise. In fact, the importance for the emerging EEU of robust economic integration with the EU cannot be underestimated for a number of reasons. First, the EU is the major trade partner for Russia and Kazakhstan, accounting for over one half of Russia’s trade, while Russia is the EU’s third largest trade partner. Second, the EU could play an important role in helping the Customs Union deal with the challenge of modernization. Third, the emerging EEU is about to spearhead a number of free-trade agreements with smaller partners. Against this background, the EU should also be regarded as the main long-term partner.

There is little doubt that progress in the EU relationship is not around the corner, given the current crisis in relations, although over the next decade many things could become possible.

In order to increase the chances for success, the EEU’s agreements with the key economic partners should be as comprehensive and action-oriented as possible. The reason behind this is that, for

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8 Analytical Report by Valdai International Discussion Club, Silk Road Economic Belt and priorities for the mutual development of Eurasian nations, Moscow, June 2015. Available at http://valdaiclub.com/publication/77920.html
example, Russia and Kazakhstan won’t benefit from a bare-bones free trade area, since raw materials dominate their exports. Given their trade structure, Russia and Kazakhstan are not interested in a narrowly defined free-trade arrangement, which would also be harmful for Belarus, although to a lesser extent. Trade concessions that are offered in one area should be offset by benefits in other areas, i.e., substantial progress must be made in other areas of economic cooperation in order for the idea of creating a free trade area to make sense.

The possible arrangements should cover trade in goods, but also in services, as well as e-commerce, investment regimes, technical regulations, non-tariff trade barriers, liberalizing access to financial markets, developing international transport infrastructure, mechanisms for reviewing and resolving trade disputes, etc.  

The Comprehensive Economic and Trade Agreement, CETA, providing a legal framework for an agreement reached in 2013 between the EU and Canada, could serve as an example and a template for integration arrangements between the EEU and the economies interested in partnering with it. The Transatlantic Trade and Investment Partnership, known as TTIP, also provides an example of a comprehensive economic and trade accord covering a number of areas on top of liberalization of trade in goods and services.  

The EEU should not seek to build Fortress Eurasia, but should instead seek to establish mutually beneficial cooperation with all of its partners.

**The EEU’s first free-trade area**

On May 30, 2015, in Kazakhstan, the EEU and Vietnam entered into an agreement to establish a free-trade area providing, among other things, for a special regime for implementing joint production projects in this country.

The agreement contains provisions that will gradually open up markets for the parties. By 2025, the import tariff in the EEU countries is to decrease from the current 9.7% down to 2%, while Vietnam is expected to cut its import tariff from 10% to 1%. Zero duties will be introduced for 60% of traded items once the treaty is ratified by the parliaments, which could take about six months, and to 88% of items after the transition period. The Ministry of Economic Development expects trade with Vietnam to double by 2020 (from $3.7bn in 2014).

The document package includes the agreement, On a Special Regime for Russian Investors and Suppliers of Services, which, among other things, enables Russian companies to conduct business in Vietnam on the same terms as local companies. Specifically, this measure is designed to benefit joint projects involving car makers (GAZ, KAMAZ, and UAZ), as well as investment in power generation, transport infrastructure and oil refining.

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Learning from other integration projects

It is important to take into account the experience of other integration bodies. In fact, the EEU keeps a watchful eye on developments in the EU, and learns from them.

The first takeaway is that the integration potential of a country is above all determined by economic factors, which means that in order to succeed, an integration project should produce real economic effects.

The second takeaway is that a single currency should have a solid foundation in the form of real and efficient mechanisms for coordinating macroeconomic policies. The Eurasian Union does not need its own Greece.

The third takeaway is that a proactive media policy is needed for the integration project to succeed.

Public attitudes and interest in the integration project is also important. It creates a positive background, determines progress, and gives political elites a strong impetus to action. A study of approval ratings of the Customs Union and the Single Economic Space conducted in the CIS captures public attitudes towards the successes and shortcomings of Eurasian integration. The Center for Integration Studies carried out a representative survey in the summer of 2014 as part of the Integration Barometer project, which found that approval ratings of the Customs Union and the Single Economic Space were high in Kazakhstan, Russia and Belarus at 84%, 79% and 68%, respectively (Figure 1). Approval was 64% in Armenia and 50% in the Kyrgyz Republic. As for approval ratings in countries that are not members of the Customs Union or the Common Economic Space, the highest figures have been reported in Tajikistan (72%) and Uzbekistan (68%), where people favor closer ties with the former countries of the USSR and above all Russia. In our opinion, this is an argument in favor of stepping up efforts to draw these two countries into EEU integration processes. 12

Figure 1. 

Question for member-states of the Customs Union: Belarus, Kazakhstan and Russia joined in the Customs Union, which made the trade between the three countries free from duties, and created the Single Economic Space (in fact, a single market of the three countries). What do you think of this decision?

Question for the states outside the Customs Union: Belarus, Kazakhstan and Russia joined in the Customs Union, which made the trade between the three countries free from duties, and created the Single Economic Space (in fact, a single market of the three countries). Do you think it is advisable for your country to join this association?, %

Agenda for the EEU Economy

Foreign investors and trade partners could be interested in working in the Eurasian Economic Union for the following reasons:

- first, investors can choose within EEU’s single space the manufacturing localization strategy that best suits their needs. For example, by establishing manufacturing facilities in the north of Kazakhstan, a company may operate in Central Asia, South Siberia and Urals;
- **second**, building on the advantages of the integration process, a single customs and economic space helps deploy efficient distribution networks;

- **third**, foreign investors can benefit from the potential and achievements of research and manufacturing clusters and infrastructure for setting up efficient production facilities and easy access to regional markets.

According to the Monitoring and Analysis of Foreign Direct Investment of EEU Countries in Eurasia, a study carried out by EDB’s Center for Integration Studies, FDI from five selected countries (Austria, Turkey, India, Vietnam and China) in EEU countries is gaining momentum. In fact, this indicator rose 69% to $58.3bn in 2008-2013.

China has shown the highest FDI growth rate. Five years ago, China was on par with India in terms of investment in the former Soviet Union, but now it is far ahead. However, this dynamic is to a large extent underpinned by large investments of the Chinese companies in Kazakhstan’s oil and gas sector, while other industries received little attention from Chinese investors until 2014. There are reasons to believe that the situation is about to undergo dramatic change.\footnote{Center for Integration Studies of the Eurasian Development Bank (2014) Monitoring of Foreign Direct Investment of Russia, Belarus, Kazakhstan and Ukraine in Eurasian Countries, Paper No. 28, St. Petersburg. Available at: http://eabr.org/general/upload/CII%20-%20izdania/2014/MIHH-2014/doklad_28_preview.pdf}

The existence of a single economic space should serve as an incentive for prospective foreign investors to invest in EEU’s economy. They will then need to choose where to set up their operations, develop logistics, determine how to benefit from the competing jurisdictions and lobby for the establishment of free-trade areas between their countries of origin and the EEU.

Consequently, the EEU offers a new realty to investors. Five countries form a single market, providing an opportunity to work from any location on their territory. Although the mechanisms behind the union’s operation have yet to undergo substantial improvements, the EEU is already a single economic space with a relatively clear development roadmap and growth prospects.
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