



CHATHAM HOUSE

Chatham House, 10 St James's Square, London SW1Y 4LE
T: +44 (0)20 7957 5700 E: contact@chathamhouse.org
F: +44 (0)20 7957 5710 www.chathamhouse.org

Charity Registration Number: 208223

Russia and Eurasia Summary

Eurasian Economic Integration: Rhetoric and Reality

18 July 2013

The views expressed in this document are the sole responsibility of the author(s) and do not necessarily reflect the view of Chatham House, its staff, associates or Council. Chatham House is independent and owes no allegiance to any government or to any political body. It does not take institutional positions on policy issues. This document is issued on the understanding that if any extract is used, the author(s)/ speaker(s) and Chatham House should be credited, preferably with the date of the publication or details of the event. Where this document refers to or reports statements made by speakers at an event every effort has been made to provide a fair representation of their views and opinions, but the ultimate responsibility for accuracy lies with this document's author(s). The published text of speeches and presentations may differ from delivery.

This document is a summary of an expert roundtable seminar, 'Eurasian Economic Integration: Rhetoric and Reality', held on 18 July 2013 at Chatham House. The Eurasian Economic Commission's recent developments and the external implications, particularly regarding the growing importance of the role of member states were discussed. Tatiana Valovaya (Eurasian Economic Commission) gave a keynote address. Other speakers included Richard Connolly (CREES, University of Birmingham), Julian Cooper, (CREES, University of Birmingham; Russia and Eurasia Programme, Chatham House), Rilka Dragneva (Birmingham Law School, University of Birmingham), Matt Frear (CREES, University of Birmingham), Asel Isakova (European Bank for Reconstruction and Development), and Kataryna Wolczuk, (CREES, University of Birmingham).

SESSION 1: ARCHITECTURE AND THE ROLE OF MEMBER STATES

The Eurasian Economic Commission, which oversees the Eurasian Customs Union (ECU) and the Single Economic Space, owes much to the European Union, having learned from its struggles and its successes. The financial crisis of 2008 signalled to those interested in Eurasian economic integration that it was important to begin seriously implementing plans for integration. Regional integration, they believed, would make the world economy more predictable and provide new mechanisms for global governance. The leaders of Russia, Belarus and Kazakhstan recognized that it would be impossible for their countries to join the EU, so they decided to create their own union.

The commission operates on two levels – the Council and the Board. The council is made up of the deputy prime ministers of the three member countries, and its presidency rotates every year. Russia, Belarus and Kazakhstan are each represented by three members on the board. While it can be difficult to make decisions and reach agreements, the composition of the council and board provides a positive atmosphere for negotiations. Representatives of the commission insist that Russia does not dominate the board's decisions. They point to the fact that the board has taken decisions contrary to Russia's wishes, and that each member country has the ability to propose the revocation of any decision they disagree with. For example, Kazakhstan recently proposed the revocation of a decision on a protectionist tax on grain imports.

Only economic issues are discussed in the Eurasian Economic Commission. Representatives have made it clear what Eurasian economic integration is

not: a political, military or security organization, a single currency area or an instrument of hasty enlargement. Problems of governance, human rights and defence will not be debated. Other Eurasian institutions, such as the Collective Security Treaty Organization, are mandated to work on those topics. However, observers disagree as to whether discussing issues such as rule of law will weaken economic integration. For example, the World Trade Organization routinely concerns itself with rule of law issues. The Customs Union should, for example, discuss property rights protection, which is integral to economic reform.

Representatives of the Eurasian Economic Commission emphasize that enlargement is not a primary goal. Instead, they speak of deepening the Single Economic Space in those countries where it already operates. All barriers to trade within the Single Economic Space are to be removed by January 2015. The commission plans to remove exemptions to free trade, which, they note, are still present within the European Union, particularly in the telecommunications sector. In terms of enlargement, the commission is adamant that it has not pressured Ukraine to join the Customs Union. Any decision taken by that country will be an internal one. In any case, the commission now considers Kyrgyzstan a more serious candidate for joining the Single Economic Space. That country has long been an advocate of Eurasian economic integration, and though it is less developed than Ukraine, its GDP per capita is not significantly lower. In May 2013, Customs Union officials began working on a road map that will allow Kyrgyzstan to join it in 2015. Commission representatives say that by joining the Customs Union, Kyrgyzstan will have more help in countering problems such as human trafficking. One issue that will have to be addressed is that of free labour movement, as there will likely be a large number of Kyrgyz workers wishing to relocate to Russia in search of employment.

The Customs Union, which came into existence in 2010, has seen some definite successes. These include the development of common customs code and legislation, investment in better dispute management mechanisms, and the creation of a supranational regulatory body, the Eurasian Economic Commission. In addition, despite the union's inherent asymmetry, codified constraints have been successful in preventing Russia from gaining dominance. Currently, the union is undergoing a period of institutional learning, increasingly adopting international standards and gaining rules-based leverage over member states.

Still, the Customs Union faces serious challenges, both transitional and structural in nature. It retains grey areas on complicated legal issues. In

addition, each member state has different motives and priorities for economic integration; observers question whether their commitment to the project will remain after changes in government. The reform necessary for the union to modernise is enormous. Still, it is important to note that current observable results of the Customs Union are short term, and analysts must wait until at least 2015 to gain a firm understanding of what the long-term consequences of economic integration will be.

Russia's role in economic integration presents challenges, as well. Because it is so much larger than Belarus and Kazakhstan, it is important that the Customs Union maintains and improves mechanisms that ensure that Russia does not dominate the project. The size of Russia's economy means that it strongly influences the success of the integration project. The recent slowdown of Russia's economy has worried some analysts, while others believe that this is a temporary anomaly in an overall growing economy. In addition to these challenges, there is a lack of expertise in Russia regarding economic integration. Though interest in the subject spans almost the entire political spectrum, there will need to be an increase in the country's capacity in this area in order for the project to be successful. Further, Russia is not accustomed to working within a multilateral framework in which it is not the dominant power. Again, only in 2015 will analysts know how well these challenges have been met.

For Belarus, Eurasian economic integration is a means by which it can pursue its own interests. Officials are not concerned about a grand idea of Eurasianism behind integration. Belarus's goals in the Customs Union have been to maintain flows of subsidized oil and gas, ensure access to markets in Russia and Kazakhstan, and to have the appeal of having an equal voice in a multilateral institution. If Belarus adheres to all of the union's conditions, it is possible that its GDP will grow substantially. In reality, actions such as Russia's push to sell Beltransgaz to Gazprom will leave the Belarusian economy dominated by Russia. Russia would like even more influence in Belarusian business. The government of Belarus did not consider strongly enough the costs that economic integration would impose. For its part, Belarus provides significant benefits to the Customs Union as a whole. Because of China's involvement in the Belarusian economy, Belarus' membership provides the Customs Union with a gateway to talks with that country. There is also important foreign investment coming from Qatar, Vietnam and Venezuela. Belarus's 'success' may also act as a 'shop window' of sorts, encouraging other countries to join the Customs Union and the Single Economic Space.

SESSION 2: ECONOMIC DIMENSION AND EXTERNAL IMPLICATIONS

Eurasian Economic Integration may lead to both trade creation and trade diversion. Trade creation occurs when a customs union causes consumption to shift from an inefficient producer to an efficient one. The price of goods decreases, while quality and flow increases. Trade diversion, conversely, occurs when a customs union or free trade area causes consumption to shift to inefficient producers. Goods become cheaper within the union, but are still high in comparison to the rest of the world. Within a customs union, both trade creation and trade diversion will occur, and efficiency of economic integration may be measured in the balance of these two processes. Regarding the Eurasian Customs Union, specifically, analysts disagree over the precise amount of trade creation and diversion, but they agree that the short-term nature of current observations means that it is difficult to gain an accurate picture of the economic reality. Over the long term, integration could result in positive economic gains for the region, assuming that these countries implement institutional reforms.

In addition to trade creation, economic motivations behind integration include increased market size, enhanced consumer choice, improved export capacity and the strengthening of institutions. Studies have already shown some positive signs as a result of the Customs Union. Since 2010, intra-union trade has increased, and the post-crisis recovery has been strong. In addition, the European Bank for Reconstruction and Development's (EBRD) Business Environment and Enterprise Performance Survey (BEEPS) has shown that the overall business climate in the region improved since the creation of the Customs Union in 2010. In general, businesses in the region have demonstrated productive engagement with economic integration institutions. For example, the Union of Industrial Entrepreneurs has been supportive of economic integration, and has developed an active committee on the issue.

Still, one must not overestimate the economic successes of the Customs Union. Structural hindrances have created challenges to economic integration in the region. Non-tariff barriers to trade still exist, and there is little evidence that this will change in the near future. There remains a strong dependence on the oil and gas sectors. The increased market size matters little for Russian producers, though it does have appeal for Belarus and Kazakhstan. There is low foreign direct investment flow within the Union, as well as from external sources. There is little likelihood that economic integration will increase the quality of local institutions, as there are few strong institutions already in the region to learn from. The economies are either too similar or

too different for there to be significant intra-industry trade. The quality of goods produced, as well as the cost of labour, in each member state, is not markedly different. There has been some intra-industry trade in the defence sector, but this is handled by the CSTO, not the Customs Union. In order for there to be significant economic gains as a result of integration, many conditions will have to be met. This is unlikely given the political will necessary for this to happen.

Eurasian economic integration solidifies the political limbo in which the countries between Russia and the European Union, such as Ukraine and Moldova, find themselves. These countries must choose between further Eurasian or European economic and political integration. So far, the EU has not been successful at promoting European integration in this region, despite the existence of the Eastern Partnership programme. This is a result of deficits in communication and structural realities. The EU has largely abandoned its promotion of democracy and human rights, and instead now focusses on regulatory convergence. This agenda is communicated to a narrow group of elites, and tends to bypass the majority of average citizens. Further, there is a mismatch between the conditionality proposed by the EU for further integration, and what the governments of the Eastern Partnership countries see as in their interests. And finally, the EU often underestimates the degree to which these countries are economically dependent upon Russia. Even Georgia, which should sign an Association Agreement with the EU this year, conducts very minimal trade with Europe – hazelnuts are Georgia's main export to the EU. The lack of membership prospective in the South Caucasus contributes to the EU's low credibility there.

Russia is taking advantage of the EU's failure in this area, attempting to undermine the case for European integration in the Eastern Partnership countries. Though European integration is viewed as providing long-term economic benefits, Russia is seen as providing immediate advantages (as well as immediate punishment if it is pushed aside). Many in the region believe that signing a Deep and Comprehensive Free Trade Agreement with the EU will lead to short-term economic losses and a lower quality of life. Other analysts counter that though it is difficult to measure the immediate consequences of signing a DCFTA, pain is reduced if a country is quickly able to implement fully all necessary reforms. The best way to avoid this is through anticipatory adaptation, which the Baltic countries engaged in during the 1990s, and which Moldova is doing now. Nonetheless, the EU still remains the gold standard of regional integration, and representatives of the Eurasian Economic Commission acknowledge this.