

The Eurasian Economic Union

- Analysis from a trade policy perspective -

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1. Subject of the investigation

Key elements of the current EAEU (“four freedoms”)

- Trade in goods
- Trade in services
- Free movement of capital
- Free movement of workers

Relative importance of these elements

- Trade is by far the most important aspect of integration
- This holds true for internal trade
- But also for trade with third countries (“external trade”)

→ Our focus: Trade

2. The relative importance of member countries

	GDP		Population		GDP per capita
	USD bn	% of EAEU	m	% of EAEU	USD
Russia	1,268	87%	143.4	80%	8,838
Kazakhstan	128	9%	17.9	10%	7,138
Belarus	48	3%	9.5	5%	5,092
Armenia	11	1%	3.0	2%	3,596
Kyrgyzstan	6	0%	6.1	3%	956

Source: IMF, Eurasian Economic Commission, Data for 2016

- Dominant role of Russia
 - 87% of EAEU GDP
 - 80% of population
- Compared to EU: GER 27% of EU GDP and 16% of EU population
- And: The living standard in Russia is much higher than in most other countries

→ **Russia is by far the largest but also the wealthiest country of the EAEU;**
no union of “equals”

3. Economic importance in international comparison

Country / trade bloc	GDP in USD bn, 2016	GDP EAEU / GDP country
USA	18,561	8%
EU-28	16,519	9%
China	11,392	13%
Japan	4,730	31%
Mercosur (BRA, ARG, etc.)	2,393	61%
India	2,251	65%
Canada	1,532	95%
EAEU	1,461	100%
South Korea	1,404	104%
Turkey	736	199%
South Africa	280	522%

Source: IMF, European Commission

EAEU GDP in international comparison

- Much smaller than USA, EU and China; also significantly smaller than Japan and Mercosur
 - Comparable to Canada and South Korea; larger than Turkey and South Africa
- EAEU is a mid-weight in the world economy

4. Importance of the EAEU in international trade

Country / trade bloc	Trade volume, USD bn, 2015	% of world trade
EU-28	3,989	12.4%
China	3,964	12.3%
USA	3,815	11.9%
Japan	1,250	3.9%
South Korea	963	3.0%
Canada	828	2.6%
India	655	2.0%
EAEU	579	1.8%
Mercosur (BRA, ARG, etc.)	527	1.6%
Turkey	351	1.1%
South Africa	149	0.5%

Source: UN Comtrade, European Commission, only trade in goods.

Note: For the trade blocs EU-28, EAEU and Mercosur only trade with third countries (internal trade excluded)

- EAEU accounts for only 1.8% of world trade
- But: Significant share of 7.5% in world energy trade

No big player in international trade; but important role in energy trade

5. Importance of the EAEU for EU trade

Country / trade bloc	Trade volume, EUR bn		% of EU trade with third countries	
	2016	2013	2016	2013
USA	609	488	17.6%	14.3%
China	515	428	14.9%	12.5%
Switzerland	264	264	7.6%	7.7%
EAEU*	218	371	6.3%	10.8%
Turkey	145	128	4.2%	3.7%
Japan	125	111	3.6%	3.2%
Norway	111	140	3.2%	4.1%
South Korea	86	76	2.5%	2.2%
India	77	73	2.2%	2.1%
Canada	64	59	1.9%	1.7%

Source: Eurostat; Note: for 2013: EAEU countries, as EAEU came into force only in 2015

- EU-EAEU trade decreased by more than 40% compared to 2013
 - EAEU is now the fourth most important trade partner of the EU after Switzerland
- **Despite massive decrease in trade, EAEU still an important trade partner of the EU**

For comparison: Trade GER-FRA amounted to EUR 167 bn vs trade GER-EAEU worth EUR 54 bn

6. The level of tariff protection vis-à-vis third countries

Average trade-weighted tariff, 2014			
Kazakhstan	8.5%	Moldova	4.5%
Russia	8.1%	Ukraine	2.7%
Belarus	5.2%	Georgia	2.0%
Armenia	5.2%	EU	2.7%
Kyrgyzstan*	3.9%	USA	2.2%

Source: WTO World Tariff Profiles; *Data for 2013

KAZ/RUS/BLR: Significantly higher tariffs than EU, USA, also higher than MLD, UKR and GEO

- KAZ: Increase from 5.0% (2008) to 9.3% (2009) because of accession to Customs Union 2010

ARM/KGZ: Extensive tariff increase agreed in the context of accession to EAEU

Armenia	2015	2022	Kyrgyzstan	2015	2020
Cars	10%	23-25%	Cars	10%	23-25%
Inorganic chemical products	0%	5%	Pharmaceuticals	0%	3-5%
Meat products	0%	5-10%	Agricultural machines	0%	2-5%

Source: Eurasian Economic Commission

→ **Very high tariff protection of the EAEU respectively of its members**

6 (cont'd). The level of non-tariff protection vis-à-vis third countries

Standards

- Since 2010 approx. 60% of Russian standards have been modernized; positive
- At the same time: 40% of standards remain outdated; trade barrier

Certification

- National certification is necessary: Costs and trade barrier

Illegal trade measures by Russia with protectionist impact

- WTO commitments are partly not complied with
- Consequence: Four WTO dispute settlement cases by the EU against Russia
- Import bans with dubious justification (e.g. health risk)
- Examples: Wine and meat from Moldova

Doing Business Index, Category “Trading Across Borders”

- Russia on rank 140 out of 190 (2017); esp. high costs for “border compliance”

→ High level of tariff and non-tariff protection

→ Protectionist character of the EAEU

7. The level of realisation of the free internal market

Many exemptions from the Single Customs Tariff (SCT)

- Exemptions for approx. 3,000 goods, which equals around 1/3 of tariff lines

Non-tariff barriers in internal trade

- Result of a research conducted by the EDB Center for Integration Studies in 2015: Non-tariff trade barriers (“NTBs”) cause 15-30% of total export value
- Internal imports worth 100 roubles → 15-30 roubles can be ascribed to NTBs; very high
- Reasons: Recognition of certificates, quotas, import bans etc.

Additionally: De facto no supranational competition policy (important difference to EU)

- Consequence: Bilateral disputes about distortion of competition (subsidies etc.)

Finally: Numerous unilateral Russian sanctions against EU, UKR, MLD

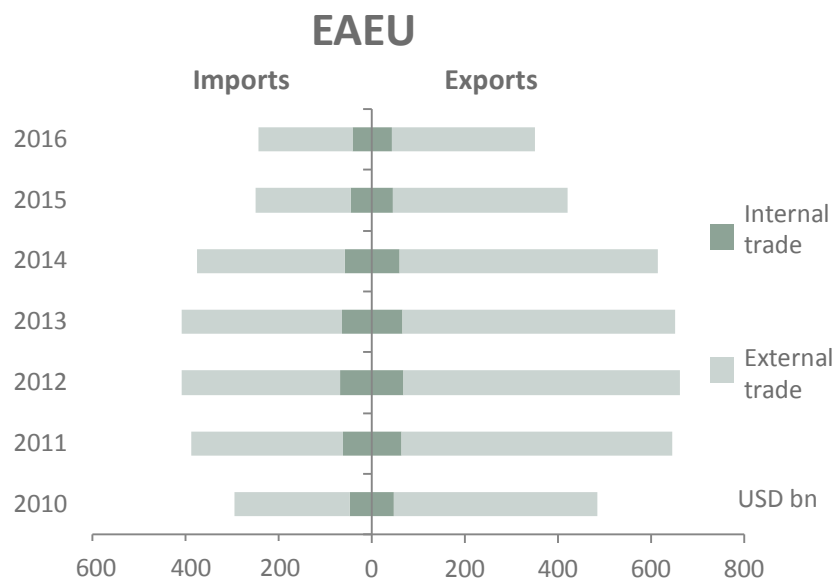
- Applied only by Russia, which weakens the internal market principle

Current state of affairs: Numerous disputes give evidence of problems named above

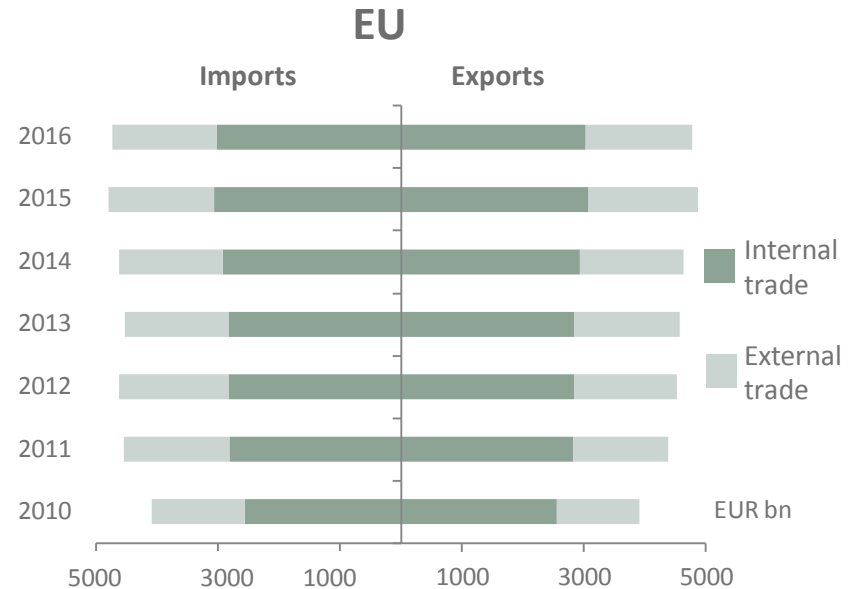
- KAZ-RUS: Meat, mayonnaise, chocolate, milk products, melons, beets
- KAZ: Import ban for potatoes from KGZ (Summer 2016)

→ **Substantial trade barriers on the “internal market”; border controls necessary**

8. Internal trade vs trade with third countries



Source: Eurasian Economic Commission



Source: Eurostat

EAEU: Trade with third countries is much more important than internal trade

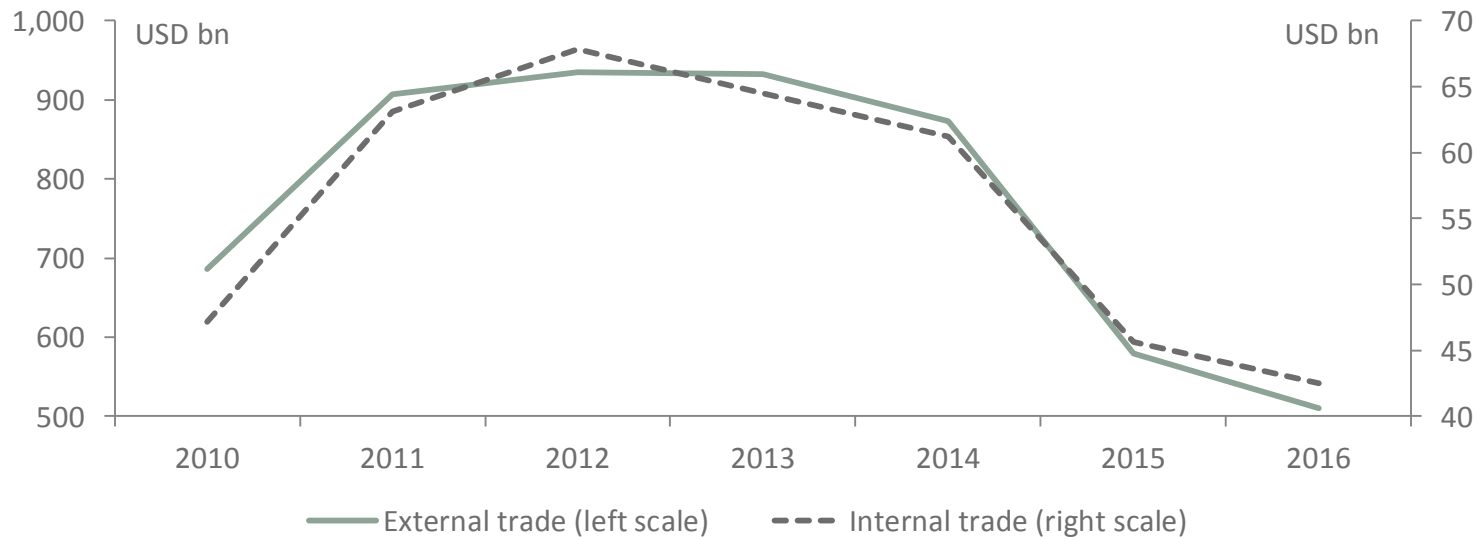
2016: 88% of total exports to third countries, 83% of imports from third countries

EU for comparison: Only 36% of export and imports with third countries

Interpretation

- Low regional integration in EAEU
- Reasons: Energy exports, size of Russia, lack of complementarity

9. Development of internal trade vs trade with third countries



Source: Eurasian Economic Commission, Note: data from 1Q2010 to 4Q2014 refer to RUS, BLR and KAZ; data from 1Q2015 refer to RUS, BLR, KAZ, ARM and KGZ

In spite of institutional integration

- No positive development of internal trade, partly due to oil price shock in 2014
- Internal trade doesn't develop more dynamically than trade with third countries

→ No observable positive impact of EAEU on internal trade

10. Structure of internal trade by countries

		Importing country, USD m, 2016					
		ARM	BLR	KAZ	KGZ	RUS	EAEU
Exporting country, USD m, 2016	ARM	-	14	6	1	371	392
	BLR	22	-	364	49	10,821	11,255
	KAZ	0	32	-	376	3,509	3,918
	KGZ	0	3	275	-	139	417
	RUS	957	15,144	9,427	1,026	-	26,554
	EAEU	980	15,194	10,072	1,452	14,840	42,536

Source: Eurasian Economic Commission

- 61% of EAEU internal trade is conducted between Russia and Belarus
- 30% between Russia and Kazakhstan, although Kazakhstan is almost 3 times larger than Belarus
- Only 2% of total trade between Belarus and Kazakhstan

→ Belarus and Russia are strongly integrated; except for that no strong integration

11. Does the EAEU make sense for the smaller member countries?

Situation before the EAEU / Customs Union for ARM, KAZ and KGZ

- Free trade in the region, but border controls, as no Customs Union in place
- Different levels of protection vis-à-vis third countries

Necessary conditions for a customs union like the EAEU to make sense

- Level of protection does not increase, as this would imply a decrease in trade
- Internal trade functions well, no border controls

For smaller EAEU members (ARM, KAZ, KGZ; not BLR)

- Tariffs increased or will increase heavily
- Internal trade is still disturbed by considerable trade barriers

→ **Current EAEU makes little sense for the trade policy of smaller member states; previous free trade zone was preferable, since it was less protectionist**

12. Which impact does the EAEU have on Kazakhstan and Armenia?

Kazakhstan

Interest: Energy exports and cheap import of modern technology to support economic development

EAEU accession: Hardly any positive impact on export, but modern technology (e.g. from the EU) became more expensive → **Negative impact**

Armenia

Interest: Promotion and diversification of exports with the help of free trade agreements, continued trade with Georgia and cheap import of modern technology (e.g. from the EU)

EAEU accession: Free trade agreement negotiated with EU could not be signed, problems in trade with Georgia, more expensive imports from third countries
→ **Highly negative impact**

→ **Clearly negative impact on Kazakhstan and especially on Armenia**

13. Does the EAEU contribute to regional integration?

Internal trade: No positive development, no positive contribution of the EAEU to regional integration

Institutionally: Mixed balance of integration

On the one hand: Stronger integration of 5 countries

- 2015: EAEU comes into force (ARM, BLR, KAZ and RUS); Sep 2015: KGZ enters

On the other hand: Institutional disintegration from 3 countries

- 2015/2016: RUS (partly) suspends free trade agreement with UKR/MLD
- Problems for transit of UKR and MLD goods via Russian territory
- Recurring problems for GEO in trade with RUS

→ **So far no positive contribution of the EAEU to regional integration; neither from a trade nor from an institutional perspective**

14. Why is the record of regional institutional integration mixed?

Main reason: Binary approach of Russia in relation to some countries of the region

- 2 options for DCFTA countries (ARM, MLD, GEO, UKR): Full integration OR trade sanctions/disintegration; “either with us or against us”
- Example Ukraine: membership in Customs Union (incl. loans, special conditions for gas, etc.) OR cancellation of free trade agreement / trade sanctions
- FTAs only for countries outside the region (Vietnam, Turkey, etc.)

EU in comparison

- Proposal to European countries: Full membership (28 countries) or participation in the European Economic Area (EFTA countries ex Switzerland) or participation in EU Customs Union (Turkey) or deep and comprehensive FTAs (UKR, MLD, GEO, etc.)
- Thus: No either-or, but different degrees of depth in integration

Russian binary approach is responsible for partial disintegration in CIS region

→ EAEU is not primarily motivated by trade policy, but rather geopolitically

15. Does the EAEU Commission have far-ranging trade competences?

In principle: Trade policy competence has been transferred to the EAEU and its Commission

But: Competence is ignored by Russia in practice, as soon as important foreign policy issues are concerned

Examples: Many unilateral decisions by Russia in the recent past

- 2013/2014: Import bans for wine/spirits/meat/fruits from Moldova
- 2014: Import ban for selected foodstuffs from sanctioning countries
- 2014: Free trade agreement with Moldova partly suspended
- 2016: Suspension of free trade agreement with Ukraine

Important: Measures were not coordinated and applied only by Russia

→ EAEU trade competence is accepted by Russia only as long as paramount foreign policy priorities are not affected

16. Is the EAEU a suitable partner for negotiations of trade issues?

EAEU Commission no “ideal” partner, as:

- Trade barriers in internal trade reduce the impact of agreements
- Agreements can be suspended unilaterally by EAEU members (esp. Russia), in case paramount priorities exist

But: Neither Mercosur is an ideal partner, nevertheless talks with the EU Commission

Thus: Differentiated view is needed

Technical questions (standards, certificates, customs clearance, etc.)

- EAEU-Commission could be a partner

Trade agreements (esp. “Lisbon-Vladivostok”)

- Absolutely unrealistic in the short term; negotiations would not make sense

→ For technical issues yes, for free trade agreements with the EU not

Note: Argumentation from a pure trade policy perspective without consideration of political restrictions

17. Is the EAEU interesting for foreign investors?

Potential model for foreign investors in the EAEU

- Investment/production in one of the member countries, sale in all five countries
- Example: Investment and production in Belarus (relatively low wages) and sale to RUS and KAZ (strong purchasing power)
- Belarus: Often used argument in the context of FDI attraction

Problem: Consistently high trade barriers in internal trade

Consequence: No incentives for foreign investors, at least in sectors with significant trade barriers

Empirical evidence: So far no systematic analysis; important research topic

→ Trade barriers in internal trade are likely to strongly limit FDI potential; however, so far a lack of empirical data on the subject

18. Current record of the EAEU and future scenarios

Current record of the EAEU from a trade policy perspective

- Higher tariff level for Kazakhstan, Armenia and Kyrgyzstan
- No positive development of internal trade in spite of EAEU
- EAEU has contributed to regional disintegration

→ **Protectionist union with a partly compulsive character; negative assessment**

Future scenarios

- Negative scenario: weaknesses stay in place, derailment of integration schedule
- Positive scenario (= EAEU potential)
 - Exemptions from the Single Customs Tariff are abolished
 - Trade barriers in internal trade are removed; no border controls
 - Competences of the EAEU Commission are strengthened
 - Conclusion of free trade agreements and reduction of tariffs

Expectation: In the short term negative scenario is more likely

→ **EAEU has potential, but its realisation is unlikely in the short term**

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19. Annex: The long way towards the EAEU

Two unsuccessful launches: Troika and Single Economic Space

1995: “Troika“

- BLR, KAZ and RUS sign a contract on the formation of a customs union
- Not implemented in practice

2003: Single Economic Space (“SES“)

- BLR, KAZ, UKR and RUS found the Single Economic Space; not implemented

Third attempt: Founding of the Customs Union and the EAEU

2010: Founding of the Customs Union by BLR, KAZ and RUS

Jan 2015: EAEU comes into power (ARM, BLR, KAZ and RUS)

May 2015: First free trade agreement of the EAEU (with Vietnam)

Sep 2015: Kyrgyzstan becomes a member of the EAEU

→ All good things come in threes?

20. Annex: Current level of institutional integration and further plans

Current level of institutional integration

- Trade in goods with exception of medicine, energy, tobacco, alcohol
- Trade in services with some exemptions (e.g. financial products)
- Labour market
- Investments

Further integration plans (Source: EAEU Commission)

- Dec 2016: Planned common market for medicine delayed
- 2017: Launch of a common electronic system for public tenders
- 2018: Common legislation for competition policy
- 2019: Common electricity market
- 2020: Common market for excise goods (tobacco and alcohol)
- 2022: Common market for audit services
- 2023: Integrated currency market
- 2025: Common financial supervision authority, which coordinates financial policy in the framework of a common financial market; common market for gas, oil and oil products