ECONOMIC ANNALS, Volume LV, No. 184 / January – March 2010
UDC: 3.33 ISSN: 0013-3264

SCIENTIFIC PAPERS

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DOI:10.2298/EKA10840075

ON THE CUSTOMS UNION OF BELARUS, KAZAKHSTAN AND RUSSIA

ABSTRACT: *The article gives a general overview of the process of forming a customs union among three Soviet successor states – Belarus, Kazakhstan and Russia. Following some theoretical considerations, the author outlines the evolution of the idea of customs union within the CIS. Thereafter, he analyses the economic situation in its member states, with particular emphasis on their structural problems, economic efficiency and trade characteristics. He comes to the conclusion that the foregoing results have not helped diversify the economic structure of its participants and lessen their import dependence. Moreover, the declining level of intra-trade does not bode well for the future of this organisation, while the situation is further complicated by the negative impact of the present global crisis and increasing geopolitical rivalry in the region.*

KEY WORDS: *economic integration, transition, Newly Independent States*

JEL CLASSIFICATION: F15, F42, F43, P20

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1. INTRODUCTION

A customs union is an agreement of two or more states to abolish customs borders between them and to create a territory with a common external tariff (CET). The commodities of each member state enter duty free into the territory of other members. The participating countries can exchange preferential market access by coordinating external tariffs to shift profits from excluded countries.

If, following the accession to the customs union, a country's exports to the member states crowds out local products or the export articles of other countries, the accession goes with a trade-creating or trade-diverting effect, which can considerably improve the balance of payments. However imports from the member states also become easier and expand, and thus the outcome may be questionable. In any case, the burden of the consequences of *trade creation* and *trade diversion* is born mainly by the outsiders or by the local producers of import articles (see Viner, 1950).

The core concept of the *Kemp-Wan theorem* (Kemp and Wan, 1976) states that members of a customs union can choose a level of common external tariff that makes the member countries better off and leaves the welfare of the non-member countries unchanged. The essence of the result is that there is always a price at which the volume of imports from outside the union remains unchanged, and yet imports from inside the union rise. This means that aggregate welfare must rise. Yeh (1998) extended this theorem to the case of import quotas. Using the partial-equilibrium approach, he showed that a customs union in the presence of import quotas would not leave each country worse off than before the formation of the customs union, whether a member of the customs union or not. .

Ornelas (2007) has shown that the exporting rents resulting from this coordination can offset trade diversion losses produced by the union, even if its members are relatively small in world markets. Such gains come, however, at the expense of excluded countries. Small countries can also use customs unions to foster multilateral cooperation, by increasing the incentives of excluded countries to support global free trade.

Facchini et al. (2008), who developed a *political economy model of trade policy under imperfect competition*, have pointed out that the necessity to coordinate tariffs in a customs union leads voters to delegate power to more protectionist representatives. This strategic delegation may imply that free trade areas increase welfare compared to customs unions.

Within the Commonwealth of Independent States (CIS), formed in December 1991, *the idea of a customs union is the basis for the realisation of an agreement creating a common economic space.* It serves to solve strictly the same task as List was carrying out for Germany in the 19th century when he proposed to unite that country. His conception was put into practice by Bismarck who became the father of the first German "economic miracle". The reason for creating a customs union in the post-Soviet space is to solve today essentially the same problems in relation to Russia and its closest allies. If they open economically to the World Trade Organisation (WTO) one by one, the result will be a division of labour threatening to make them an absolute periphery. If they close their economies, degradation will be the consequence.

Dugin (2006) suggested that this equation could be solved by forming a customs union based on a *specific economic philosophy*. He emphasised that List had been a pragmatic liberal who called his theory "economic nationalism", implying an implementation of liberal economics and its methods that would strengthen a nation, not weaken it. Therefore, the achievement of a customs union within the CIS demands a switch of Russia's economic policy from the isolationism of the Soviet period and the subsequent ultra-liberalism and globalism to a *third-way innovative economy*. It is on the speed of this process that the transition of Russia and its allies to a totally new quality with a new development path depends.

In this connection, the author's hypothesis is that the *formation of a customs union in the post-Soviet space can help diversify the economic structure of its member states and lessen their import dependence*. Following some theoretical considerations, the evolution of the idea of customs union within the CIS is to be outlined. Thereafter, before the conclusion, the economic situation in its member states will be analysed, with a particular emphasis on their structural problems, economic efficiency and trade characteristics.

2. SOME THEORETICAL CONSIDERATIONS

Formation of *international organisations* is induced by processes of micro and macro *integration*. Generally, international economic integration implies a macro- and micro-level junction of several national economies, viz. a widening cooperation in production, trade, research and development (R&D), and innovations among their productive and servicing units. Macro integration is based on an interaction of participating states' markets and institutions, whereas micro integration is an interpenetration of their corporate spheres in the form of

joint ventures and producers' associations. *Integrations and economic groupings always have a double effect.* On the one hand, these organisations facilitate trade and economic relations among their member states, but on the other, they hinder trade with outsiders, with a mostly unfavourable effect on their balance of payments (Szentes, 1999: 348–349).

Specialist literature distinguishes the following *forms, or stages, of macro integration* (see Balassa, 1961):

(1) *Preferential customs area* means that countries participating in it on the basis of a preferential trade agreement offer each other customs and other trade policy preferences. These preferences can include a tariff lower than applied to outsiders and a mutual duty-free trade.
(2) In a *free trade area*, trade is liberalised; while towards outsiders, each country pursues its own customs policy.
(3) In a *customs union*, not only is trade totally liberalised, but also common tariffs and trade policy are applied towards non-member countries.
(4) The *common market* is more than a customs union in that, beyond ensuring a free internal movement of goods and services, it also liberalises capital and labour flows.
(5) In an *economic and monetary union*, the participants, in addition to creating a common market, harmonise, coordinate and standardise and, in the final phase, unify their national economic policies.
(6) *Political union* leads to the creation of a single state.

The *theory of customs union* was originally elaborated by List, who represented a point of view different from that of Smith and Ricardo. According to the latter liberal economists, if two countries mutually lift tariff barriers and totally liberalise their foreign trade, the consequence is the equalisation of the living standards in both of them. List has stated that this hypothesis is not confirmed by practice, showing that such lifting leads to a transfer of the hardest and most low-paying work to a less developed nation, with dividends gained by a developed one. Thus, the lifting of all tariff barriers results in a disproportionate development of economies – the rich grow richer and the poor poorer. But if the state lagging behind in development does not take part in foreign trade at all, it will also degrade. List proposed a third way which was not integration and not isolation. This was called customs union when a nation did not become totally open but could not remain closed. Thus, the philosophy of a customs union is to unite a maximal number of economies with a similar level of development, common cultural and historic values, and to pursue foreign trade jointly,

rationally controlling everything that goes through the borders of such a union. The economy, including trade and transport, is totally liberalised in the customs union but its borders are filtered. This involves a certain degree of globalisation, i.e. openness in foreign trade, which is not absolute, but relative (see List, 2009).

In sum, customs union implies a form of economic integration supposing replacement of the customs areas of member nations with a single customs area within whose boundaries a single customs tariff operates, along with a single foreign trade policy towards third countries, uniform rules of customs regulation, as well as a single supranational body which must regulate foreign trade, activities of definite production and trade spheres and decide on customs union-related matters.

3. EVOLUTION OF THE IDEA OF CUSTOMS UNION WITHIN THE CIS

The *Agreement on a Customs Union* (CU) *of the CIS* was originally signed by Belarus, Kazakhstan and Russia in Moscow on 20 January 1995. On 10 October 2000, these three countries together with Kyrgyzstan and Tajikistan concluded in Astana a Treaty on the Establishment of the *Eurasian Economic Community* (EURASEC) (In 2006–2008, Uzbekistan was also a full-fledged participant.) Within the EURASEC, the envisaged customs union supposed a decision-making mechanism with voting shares according to the economic potential of each country. However, the corresponding international bodies were not formed (Simon Jr., 2009: 3). Thus, in practice the EURASEC member states did not get beyond the level of a free trade area in which 60% of customs tariffs were unified and some anti-dumping procedures were applied (Glinkina, 2008: 6).

In February 2003, the Organisation of Regional Integration was created by Belarus, Kazakhstan, Russia and Ukraine, the most developed countries of the Commonwealth with close economic connections both in the raw materials and manufacturing sectors. The founding documents of the *Common Economic Space* (CES) were signed in Yalta on 19 September 2003 and ratified by parliaments of the relevant countries in April-May 2004. The CES, uniting the customs areas of its participating states, envisaged not only a free flow of goods, services, capital and labour on the principles of fair competition in a common market, but also the introduction of a single currency, coordinated trade, fiscal, monetary and credit systems, and exchange rate and financial policies, with a harmonisation of corresponding legislation and formation of a supranational Commission on trade and tariffs. Within this framework, each participant was free to decide in which directions or measures of integration to participate and to what extent, without a

right to block the progress of its partners. Decisions of fundamental importance would have been made considering the economic weight of participants. However, Kiev, having taken a course towards European integration, did not intend to progress beyond a free trade area and to bind itself by any far-reaching obligations within the CES and the whole Commonwealth. Therefore the heads of state of the remaining three participants – Belarus, Kazakhstan and Russia – took a decision at the meeting of the Interstate Council (IC) of EURASEC held in Sochi on 16 August 2006 to form, instead of the CES, the legal basis of a *new customs union*, which Kyrgyzstan, Tajikistan and Uzbekistan could join as they got ready to do so (Andrianov, 2005: 58–59; Shumsky, 2005: 114–117; Simon Jr., 2009: 4–5).

This issue was considered at the IC meeting in Dushanbe on 6 October 2007 when some agreements on the subject were signed. A Commission of the Customs Union was set up as a single standing regulatory body, which held its first session in Minsk on 4 February 2009, as well as two ICs – one at the level of heads of state and another at the level of the heads of government of Belarus, Kazakhstan and Russia. At the IC meeting of presidents A. Lukashenko, N. Nazarbayev and D. Medvedev, held in Minsk on 27 November 2009, a package of decisions was signed, regulating the activities of the Customs Union of EURASEC, which was to become a serious step towards a higher stage of integration – a new CES. An agreement was reached that a *full-fledged customs union* was to be operable by 1 January 2010 and all the common customs tariffs were to be harmonised before the 9 June tripartite meeting of heads of government in Moscow. State customs control was to be abolished on the Belarusian-Russian border from 1 July 2010 and on the Russian-Kazakh border from 1 July 2011.

At the IC meeting of EURASEC held in Saint Petersburg on 11 December 2009, its prime ministers were informed of progress achieved in creating the CU and CES within the EURASEC and of the activities of the Interstate Council of the Customs Union at the level of heads of government. The latter body adopted agreements on common trading, sanitary, veterinary and quarantine measures, rules and certificates, including the mutual recognition of certificating organs and experimental laboratories or centres; as well as protocols on changes in the principles, rules and control of indirect taxation and on cooperation in trade statistics.

Currently, *Belarus, Kazakhstan and Russia are jointly conducting negotiations on accession to the WTO*, planning to become members at the same time, either as a single customs area or separately but on mutually agreed terms. It is important to stress that the establishment of the EURASEC customs union and common

economic space will enable the whole Community to become a rapidly developing organisation for regional integration, able to ensure effective use of the existing economic potential to raise the living standard of its peoples.[1]

4. THE ECONOMIC SITUATION OF THE CUSTOMS UNION

The plans to establish a customs union among the Soviet successor states are generally not optimistically evaluated in the specialist literature. Thus, Michalopoulos and Tarr (1997), who analysed the economic implications for potential members of the Customs Union of the CIS, pointed out that such a union would tend to lock them into the old technology of the former Soviet Union, while its static effects would be more harmful to countries with relatively liberal trade regimes applying lower average and less differentiated tariffs than the CET that was then contemplated by the proposed Customs Union. Later on, an econometric analysis of the feasibility of the idea of a currency union of Russia, Ukraine, Belarus and Kazakhstan led Chaplygin et al. (2006) to conclude that there was a lack of structural symmetry and market flexibility among the potential participants and would be an asymmetric pattern of shocks. Dugin (2006) emphasised that such opinions as a rule reflect the views of Euro-Atlantist circles that sponsored the recent "coloured revolutions" in the CIS and even certain Russian liberals with close connections to Washington. It was the Orange Revolution in Kiev that led to Ukraine's withdrawal from the CES. In this context, Dugin considers the Customs Union as the main stake in the struggle for predominance in the post-Soviet space on which the destiny of Russia and the international balance of powers depend.

Table 1. Share of Customs Union in the world GDP, trade and FDI flows

(per cent)

Year	GDP (PPP-based)	Exports f.o.b.	Imports c.i.f.	FDI	
				Inflows	Outflows
1995	3.25	1.88	1.56	0.89	0.17
2000	2.97	1.91	0.95	0.30	0.26
2005	3.41	2.76	1.62	1.56	1.44
2006	3.50	3.02	1.87	2.49	1.63
2007	3.61	3.09	2.19	3.44	2.29
2008	3.71	3.64	2.47	5.13	3.03

Calculated from: International Financial Statistics Yearbook. IMF, Washington, D.C., various volumes; IMF, World Economic Outlook Database; UNCTAD, FDI/TNC Database.

1 See the EURASEC website, http://www.evrazes.com

The CU countries possess a significant natural and economic potential. In 2005, their joint share in world population amounted to 2.6%, compared to 2.2% of Russia, 4.3% of the CIS and 7.1% of the EU-25 (Eurostat, 2008: 22–23). In the same year, Russia's share in the world's proven recoverable reserves comprised 6.4% of crude oil and 27.1% of natural gas, with Kazakhstan's indicators being 1.9 and 1.7%, respectively (United Nations, 2008: 556–561). Russia was the 2nd and Kazakhstan the 14th largest oil exporter in the world (Najman et al., 2007: 14). Russia's Gazprom, which at the turn of millennium began a powerful expansion in both domestic and foreign investments, gained a monopolistic position in the country's gas sector (Weiner and Ludvig, 2007: 164). Nevertheless, between 1995 and 2008, the Customs Union managed to achieve only a slight increase in its contribution to the world's gross domestic product (GDP), whereas its relative weight in world trade expanded from 1.72 to 3.06% and in world net FDI inflows from 0.53 to 4.08% (see Table 1). In 2001, the CU accounted for only 0.57% of the world's gross domestic expenditure on research and development (GERD), of which 0.55% fell to Russia (UNCTAD, 2005: 287–288). Not better is the situation with the use of information technologies. In 2006, the number of Internet users per 100 people made up 56.3 in Belarus, 18.0 in Russia and 8.1 in Kazakhstan, whereas in the United States it was much higher (69.5) (World Bank, 2008: 308–310). Thus, the *integration has not yet overturned the unfavourable trends related to an insufficient participation in the international division of labour.*

In 2008, the real GDP made up 167% of its 1990 level in Belarus, 141% in Kazakhstan and 110% in Russia. In the total Customs Union, the given indicator reached 115%, compared to 110% on average in the Commonwealth (Table 2). The GDP per inhabitant in 2005 was 10,033 euros at purchasing power parity (PPP) in Russia, 7,358 euros in Kazakhstan and 7,225 euros in Belarus, making them the economically most developed countries of the CIS. This respectively comprised 43, 32 and 31% of the average level of the EU-25 (Eurostat, 2008: 23, 45).

It should be noted that in 1991 when an *economic transformation* began in all of the CIS countries, based on predominantly neo-liberal principles, disintegration of previous links, emergence of customs borders, disappearance of guaranteed demand on domestic production, a budget crisis and inflation became their common problems. *The less diversified was the economy, the stronger became the trade shock.* Under common tasks and objectives, each state chose reform scenarios, priorities and sequence depending on the assessment of capabilities and setting out from a changing business environment. As a result, substantial differences emerged in legal frameworks and economic mechanisms, directions and means of regulating economic relations. The situation was complicated by the

fact that *simultaneously systemic and structural changes had to be implemented, along with an anti-crisis macroeconomic policy*. If following the collapse of the Soviet Union state power became weakened, including its ability to regulate the economy, later on it was strengthened and consolidated. Moreover, *in Belarus, Kazakhstan and Russia economic stabilisation was accompanied by increasing authoritarian tendencies* (Simon Jr., 2009: 17).

Table 2. Volume indices of real GDP in the CIS

(as percentage of the previous year)

Year	BY	KZ	RU	***CU***	AM	AZ	GE	KY	MD	TJ	TM	UA	UZ	**CIS**
1991	98.6	89.0	95.0	***94.8***	88.4	99.4	78.9	92.1	82.5	91.5	95.3	91.3	99.5	**93.9**
1992	90.4	94.7	85.5	***86.4***	58.2	77.4	55.1	86.2	71.0	67.7	94.7	90.1	88.9	**86.2**
1993	92.5	90.8	91.1	***91.2***	91.2	76.9	70.8	84.5	98.8	83.7	90.0	85.8	97.7	**89.9**
1994	88.4	87.4	87.3	***87.4***	105.5	80.3	89.6	79.9	69.0	78.7	82.7	77.1	94.8	**85.5**
1995	89.6	91.8	95.9	***95.3***	106.9	88.2	102.6	94.6	98.6	87.6	92.8	87.8	99.1	**94.2**
1996	102.8	100.5	96.4	***97.0***	105.9	101.3	111.2	107.1	94.1	83.3	93.3	90.0	101.7	**96.3**
1997	111.4	101.7	101.4	***102.0***	103.3	105.8	110.5	105.9	101.6	101.7	88.7	97.0	105.2	**101.4**
1998	108.4	98.1	94.7	***95.8***	107.3	110.0	103.1	102.1	93.5	105.3	106.7	98.1	104.3	**97.0**
1999	103.4	102.7	106.4	***105.9***	103.3	107.4	102.9	103.7	96.6	103.7	116.5	99.8	104.3	**105.1**
2000	105.8	109.8	110.0	***109.7***	105.9	111.1	101.8	105.4	102.1	108.3	118.6	105.9	103.8	**108.9**
2001	104.7	113.5	105.1	***105.7***	109.6	109.9	104.8	105.3	106.1	109.6	120.4	109.2	104.2	**106.4**
2002	105.0	109.8	104.7	***105.1***	113.2	110.6	105.5	100.0	107.8	110.8	115.8	105.2	104.0	**105.4**
2003	107.0	109.3	107.3	***107.4***	114.0	111.2	111.1	107.0	106.6	111.0	117.1	109.6	104.4	**107.9**
2004	111.4	109.6	107.2	***107.7***	110.5	110.2	105.9	107.0	107.4	110.3	114.7	112.1	107.7	**108.4**
2005	109.4	109.7	106.4	***106.9***	113.9	126.4	109.6	99.8	107.5	106.7	113.0	102.7	107.0	**106.8**
2006	110.0	110.7	106.7	***107.3***	113.2	134.5	109.4	103.1	104.8	107.0	111.4	107.3	107.3	**107.9**
2007	108.6	108.9	108.1	***108.2***	113.7	125.0	112.3	108.5	103.0	107.8	111.6	107.9	109.5	**108.8**
2008	110.0	103.3	105.6	***105.7***	106.8	110.8	102.1	107.6	107.2	107.9	110.5	102.1	109.0	**105.7**

Note. Here and below, AM = Armenia, AZ = Azerbaijan, BY = Belarus, GE = Georgia, KZ = Kazakhstan, KY = Kyrgyzstan, MD = Moldova, RU = Russia, TJ = Tajikistan, TM = Turkmenistan, UA = Ukraine, UZ = Uzbekistan, CU = Customs Union, CIS = Commonwealth of Independent States. Figures for the CU and CIS are author's own calculations.

Sources: CIS STAT; IMF; EBRD; Heston et al. (2006).

During the 1990s, in the CU and other CIS countries, the common features of reforms were liberalisation, privatisation and a general widening of market relations. *Specific measures* were aimed at lessening external dependence on raw materials, foodstuffs, military and other technologies. Price liberalisation revealed the inefficiency of several forms of cooperation, while the lifting of restrictions on foreign economic activity exposed the low competitiveness of most industries. *By the mid-1990s the formation of market relations and development of private entrepreneurship had led to a shift in economic links from an interstate*

to a microeconomic level. The Customs Union and the Commonwealth as a whole enhanced the independence and sovereignty of their members, as well as their choice of own reform models, allowing them to mitigate the negative consequences of the disintegration of the USSR and preserve many cooperation links. However, integration opportunities are substantially restrained by such factors as an uneven distribution of economic potential, a non-unified legal base, military conflicts, contradictions between national policy objectives and the interests of the World Bank and IMF. Although the transformational recession in most CIS countries is already over (see Table 1), the first generation reform tasks have as yet only partly been solved: economic growth has been restored (in a new output structure) and a quite unstable market space has formed. At the same time, such countries as Russia and Kazakhstan have already been tackling some second-generation issues, initiating pension reform and strengthening the competitiveness of the energy sector, railway transport and telecommunications (Simon Jr., 2009: 18).

Russia, like Ukraine, Moldova and Kyrgyzstan, totally liberalised its economy, but for a long time failed to maintain discipline through hard budget constraints.[2] It could not contain tunnelling, i.e. the legal expropriation of income and assets belonging to minority shareholders, and theft through either law or administrative control. Russia encouraged new entry early in the transition. However, the capture of the state by a narrow set of vested interests – old enterprises and well-connected early entrants – discouraged further entry at later stages of transition and created a *poor investment climate*. This resulted in a pattern of protection and selective encouragement.

Belarus, like Turkmenistan, and Uzbekistan, did not harden budget constraints, and from the very beginning strongly discouraged new entry. Access to foreign exchange and credit on special terms softened the budget for state enterprises. *Reliance on mechanisms inherited from the command economy* continued. The survival of a highly centralised structure of political power did limit the extent of asset stripping and other forms of theft that proved so damaging to growth in Russia. Yet this element of discipline came at the cost of a highly protective stance that discouraged entry of new enterprises, including small- and medium-sized ones (World Bank, 2002: 27, 34).

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2 Hard budget constraints are said to exist when managers of public enterprises know the budgets set for them by central government are fixed and that losses will not be financed out of general revenues or by the central bank (World Bank, 1996: iii).

In this connection, Grigoryev and Salikhov (2007: 24–26) distinguish *three models of socio-economic development of the CIS countries*: (a) migratory, (b) industrial and (c) resource-based.

Model (a) is characterised by migrant workers' remittances on which no taxes are paid. Under the conditions of a transition economy, this model was realised in Armenia, Georgia, Kyrgyzstan, Moldova, Tajikistan, Uzbekistan and, partly, Ukraine.

Model (b) presupposes a higher foregoing level of industrialisation and attempts to preserve industry for the future. Within its scope, *relatively stable markets* are formed, and *enterprises with former Soviet assets* are preserved. This model makes it possible to maintain a higher competitiveness of human capital. At the same time, it is burdened with *acute problems* of property rights, tax collection from enterprises, formulation of a realistic industrial policy, and preservation of scientific and educational potential. This model is typical for *Belarus*, the eastern regions of Ukraine and Transnistria.

Model (c) is based on the considerable *incomes of the state and raw material branches*, creating institutional problems for the development of the manufacturing sector and exacerbating the *dependence on the volatility of world market prices of exported raw materials*. It is present in Azerbaijan, *Kazakhstan* and Turkmenistan (Azerbaijan came to it from the migratory model).

Russia in a regional aspect possesses characteristics of all three models, remaining an important market of goods, source of raw materials, energy carriers and private investments, whose economy employs a significant amount of surplus labour (Ibid. 27).

Table 3. Value added by economic activity

(per cent)*

Code	Agriculture *A-B*		Industry *C-E*		*Of which*: Manufacturing *D*		Services *F-O*	
	1992	2004	1992	2004	1992	2004	1992	2004
AM	30.1	24.4	33.6	23.8	20.6	14.6	36.3	51.8
AZ	27.7	11.7	33.4	41.0	7.3	8.9	38.9	47.3
BY	23.2	10.2	41.7	33.0	39.9	31.6	35.1	56.8
GE	55.1	22.2	14.6	13.1	11.0	8.9	30.3	64.7
KZ	22.9	7.4	34.5	30.6	8.8	13.9	42.6	62.0

KY	39.0	32.8	35.8	21.1	31.6	16.8	25.2	46.1
MD	37.5	19.9	29.8	19.4	25.3	16.5	32.7	60.7
RU	7.3	6.0	35.5	30.8	24.7	17.7	57.2	63.2
TJ	25.9	21.5	37.1	29.8	29.5	23.7	37.0	48.7
TM	18.6	19.1	57.8	40.0	40.8	28.3	23.6	40.9
UA	19.5	11.7	44.0	28.0	34.5	20.1	36.5	60.3
UZ	34.8	20.2	27.8	30.5	21.6	14.9	37.4	49.3
CIS	***28.5***	***17.3***	***35.5***	***28.4***	***24.6***	***18.0***	***36.0***	***54.3***
CU	*17.8*	*7.9*	*37.2*	*31.5*	*24.5*	*21.1*	*45.0*	*60.6*

* Gross value added including financial intermediation services indirectly measured (FISIM) at current prices.

Calculated from: CIS STAT and national statistics data.

As seen from Table 3, the share of agriculture in the production of gross value added in all the countries of the CIS, including the Customs Union, significantly contracted, with a simultaneous increase in the contribution of the tertiary sector as a consequence of the growth of the previously underdeveloped trade, communications and commercial services (see Table 3). In industry, the switch-over to world market prices created favourable conditions for the growth of raw material branches and unfavourable ones for the development of manufacturing, primarily engineering, light and food industries. All this gives evidence of a *structural convergence making integration more difficult* when an excessive development of mining and raw material branches transforms these economies into resource segments of the world market, depriving them of interdependence and inter-complementary character (Simon Jr., 2009: 15–16).

Table 4. Macro indicators of economic efficiency in Belarus, Kazakhstan and Russia

(average annual change, per cent)

Indicator	1991–2008			1991–1999			2000–2008		
	BY	KZ	RU	BY	KZ	RU	BY	KZ	RU
Y	2.9	1.9	0.5	-1.9	-5.0	-5.3	8.0	9.4	6.8
K	1.3	2.8	1.2	1.0	0.1	0.6	1.5	5.5	1.8
L	-0.6	-0.1	-0.3	-1.6	-3.0	-1.8	0.5	2.8	1.3
Y/L	3.4	2.1	0.8	-0.3	-2.0	-3.6	7.5	6.3	5.4
Y/K	1.6	-0.8	-0.6	-2.9	-5.1	-5.9	6.3	3.6	4.9
K/L	1.9	2.9	1.4	2.7	3.2	2.5	1.0	2.6	2.6

Note. *Y* = GDP, *K* = fixed assets (both at comparable prices of 2000), *L* = employment, *Y/L* = labour productivity, *Y/K* = capital productivity, *K/L* = capital intensity.

Calculated from: Table 3.

What characterises the *economic efficiency* of the member states of the Customs Union? Overall in the period 1991–2008, it was the Belarusian economy that showed the fastest GDP growth. Fixed assets expanded most rapidly in Kazakhstan where employment contracted least of all. Only there was the growth rate of fixed assets higher than that of GDP. In all three countries, the increase in labour productivity ensured the total growth of GDP, compensating for the impact of employment contraction. Capital productivity increased only in Belarus, while capital intensity was most fast growing in Kazakhstan, which primarily reflected the impact of its dynamic oil sector. In the sub-period of 1991–1999, it was the Russian economy that suffered most from the transformational recession. But even then in all three countries, an increase in fixed assets and, more pronouncedly, in capital intensity could be observed. In the sub-period of 2000–2008, the Customs Union's economy totally recovered from the transformational crisis. The fastest rate of economic growth was achieved by Kazakhstan followed by Belarus and Russia. It was also the Kazakh economy where fixed assets and employment showed the most rapid expansion. The increase in labour productivity contributed to the growth of GDP by around nine-tenths in Belarus, four-fifths in Russia and two-thirds in Kazakhstan (Table 4).

Many analysts turn attention to the *dangers and problems connected with the fluctuations of oil prices*. They point out that a faster growth, related to an increase in oil and gas revenues, took place in Russia without the elimination of its structural and competitive weaknesses (Csaba, 2006: 311–312. This is also true for Kazakhstan). At the same time, one can positively assess the fact that the recent appreciation of the rouble has induced Russian enterprises to cut their costs and, using advanced technology, to raise competitiveness (Weiner, 2004: 5). For Russia, the Urals oil price, having a determining economic importance, was mostly unfavourable in the period from 1985 to 1998, but thereafter the situation radically changed. Previously it contained, but after the default it began to feed, economic growth, in which oil extraction played an outstanding role, with a record high 8.5% average annual rate of growth in 2000–2004 (Weiner, 2008: 151–152).

As for Kazakhstan, it has an enormous demand for international capital and technology inflows, qualified specialists and a transparent public administration, capable of running a modern economy. However, numerous elements of such an economy are still missing. Thus, transport infrastructure is not adequately designed, including the pipeline system transporting energy carriers (Tarjányi, 2008: 233).

Table 5. Openness of the economy

(in percentage of GDP)

Indicator	1995			2000			2007		
	BY	KZ	RU	BY	KZ	RU	BY	KZ	RU
1. Exports of goods and services	49.7	37.7	29.3	64.7	56.8	44.1	61.7	50.1	30.7
2. Imports of goods and services	54.0	42.1	25.9	68.2	49.3	24.0	67.8	43.2	22.0
3. *Openness* (1+2)	*103.7*	*79.8*	*55.2*	*132.9*	*106.1*	*68.1*	*129.5*	*93.3*	*52.7*

Calculated from: International Financial Statistics Yearbook. IMF, Washington, D.C., various volumes.

In principle, integration, including the formation of a customs union, is easier among open economies. As shown in Table 5, of the three countries of the CIS/EURASEC Customs Union, the highest degree of economic openness has been attained by Belarus, followed by Kazakhstan and Russia. Similar was the situation with export orientation.

Table 6. Interstate trade within the Customs Union

Country, group	1995				2000				2008			
	BY	KZ	RU	*CU**	BY	KZ	RU	*CU**	BY	KZ	RU	*CU**
In percentage of exports												
BY	–	1.0	3.8	–	–	0.2	5.4	–	–	0.3	3.7	–
KZ	1.6	–	3.4	–	0.3	–	2.2	–	1.1	–	3.1	–
RU	44.4	44.8	–	–	50.6	17.7	–	–	38.2	12.2	–	–
CU	*46.0*	*45.8*	*7.2*	***33.0***	*50.9*	*17.9*	*7.6*	***25.5***	*39.3*	*12.5*	*6.8*	***19.5***
In percentage of imports												
BY	–	2.0	4.2	–	–	0.8	11.1	–	–	0.9	3.9	–
KZ	1.0	–	5.9	–	0.5	–	6.5	–	0.4	–	2.5	–
RU	56.1	49.9	–	–	64.8	48.3	–	–	59.8	36.4	–	–
CU	*57.1*	*51.9*	*10.1*	***39.7***	*65.3*	*49.1*	*17.6*	***44.0***	*60.2*	*37.3*	*6.4*	***34.6***

* Average.

Calculated from: Direction of Trade Statistics Yearbook and Quarterly. IMF, Washington, D.C., various volumes.

Table 7. Merchandise trade by commodity

Section	2000				2008			
	BY	KZ	RU	*CU**	BY	KZ	RU	*CU**
In percentage of exports								
Agricultural products	10.6	8.5	7.3	*8.8*	8.2	4.5	5.4	*6.0*
Fuels and mining products	21.1	74.4	68.5	*54.7*	38.7	81.6	74.3	*64.9*
Of which:								
Fuels	20.3	53.8	51.7	*41.9*	38.1	69.3	66.5	*58.0*
Manufactures	68.3	17.1	24.2	*36.5*	53.1	13.9	20.3	*29.1*
Of which:								
Iron and steel	3.8	12.8	7.0	*7.9*	5.1	8.3	7.1	*6.8*
Chemicals	13.3	1.2	6.9	*7.1*	15.5	2.7	6.0	*8.1*
Machinery and transport equipment	41.8	2.9	9.5	*18.1*	29.3	2.8	7.1	*13.1*
Textiles	5.7	0.1	0.4	*2.1*	1.8	0.1	0.1	*0.7*
Clothing	3.7	0.1	0.4	*1.3*	1.4	0.0	0.0	*0.4*
In percentage of imports								
Agricultural products	14.7	10.3	20.9	*15.3*	9.0	8.6	11.9	*9.8*
Fuels and mining products	34.6	14.5	8.6	*19.2*	40.6	16.3	4.3	*20.4*
Of which:								
Fuels	30.9	11.5	3.7	*15.4*	36.7	14.7	1.6	*17.7*
Manufactures	50.7	75.2	70.5	*65.5*	50.4	75.1	83.8	*69.8*
Of which:								
Iron and steel	6.9	7.1	3.5	*5.8*	7.4	11.2	3.0	*7.2*
Chemicals	12.1	10.3	11.1	*11.2*	9.3	8.7	9.3	*9.1*
Machinery and transport equipment	28.0	56.6	46.8	*43.8*	31.8	54.2	62.2	*49.4*
Textiles	3.1	0.9	3.0	*2.3*	1.6	0.6	1.9	*1.4*
Clothing	0.6	0.3	6.1	*2.4*	0.3	0.4	7.4	*2.7*

* Average.

Calculated from: WTO Statistics Database.

Although the USSR itself was a closed economy, *Soviet planners fostered specialisation rather than diversification* within each republic. The result was very little trade with the rest of the world and very large commodity flows between republics. Since the collapse of the Soviet Union, several largely unsuccessful attempts have been made to restore trade among the newly independent states

(NIS) and reduce adjustment costs through regional trade arrangements. Several "free trade" agreements have been concluded, but these were free in name only, because most of the countries preserved export controls on key products. Therefore, establishing a sound interstate payment system and full convertibility of currencies is vital to market-based trade among the NIS. *Trade barriers should be removed on a non-discriminatory basis*, to deepen the integration of the CIS into the world economy (cf. World Bank, 1996: 133).

For the three-member Customs Union's future, it bodes ill that the not very high extent of its intra-trade shows a declining trend. Overall, this indicator for the bloc's total turnover of goods decreased from 36.4% in 1995 to 34.8% in 2000 and 27.1% in 2008. Hitherto, trade with CU partner countries has been much more important for Belarus and Kazakhstan than for Russia (see Table 6). Thus, the decrease in intra-trade implies that trade diversion is bigger than trade creation. Among the reasons, one can mention the increasing centrifugal tendencies and great power rivalries in the broader post-Soviet space, as well as the Eastern Neighbourhood Policy of the European Union, which, in the author's opinion, is deliberately aimed at undermining the whole CIS (cf. Simon Jr., 2009: 20). In this context, finding a new form of the Commonwealth would give a serious impetus to the cause of the CU, which could be dynamised by a possible accession of Ukraine. However, Kiev has made it clear that it will consider the issue only if its accession does not contradict its obligations deriving from WTO membership.

Data in Table 7 confirm the *predominantly resource-oriented character of the Kazakh and Russian economies in contrast with the more industrialised Belarusian one*. This makes the exports of the Customs Union as a whole dominated by energy carriers and raw materials, whereas in imports finished goods prevail. In the period between 2000 and 2008, the share of fuels and mineral products in CU exports increased from more than a half to an almost two-thirds, whereas in the bloc's imports, the relative weight of machinery and equipment expanded from two-fifths to nearly a half (see Table 7). *Such trends do not encourage sustainable economic development*, as raw material prices are prone to significant cyclical fluctuations, while manufactured imports are financed mostly from raw material export revenues.

In the case of *Belarus*, the dividends of its aspirations to reintegrate with Russia manifested themselves in the entry of Belarusian goods into the Russian market, cheap energy carrier imports and even a write-off of Belarusian gas arrears in 1996, as well as an increasing capacity utilisation of oil refineries (Weiner, 2007: 135). Belarus, which has a serious bargaining advantage due to its transit role,

is also a significant beneficiary of oil refining: it imports crude oil from Russia, which is processed in two big oil refineries and then exported. Until the turn of 2006/2007, Belarus carried out this transaction in an exceptional position, as Russia, because of the Customs Union, did not apply an export tariff to its crude oil, while Minsk did not pay anything to Moscow for the refined and re-exported Russian oil products. After the contracting parties were not able to agree on revenue sharing, Russia imposed a $180.7 export tariff on crude oil exports to Belarus from 1 January 2007. In response, Minsk introduced a $45 tariff for oil transit through Belarus to Europe during the first week of 2007. Since Russia was not willing to pay, Belarus tapped the transit oil. For that reason, on 8 January 2007 Russia turned off the Druzhba ("Friendship") oil pipeline. It is noticeable that Belarus had previously rejected the Russian claim to share in the latter's favour the export tariff of oil products in an 85 to 15% proportion. Analysts also saw behind these developments attempts to weaken the Lukashenko regime, acquire for Russian companies the Belarusian oil refineries, increasing Minsk's economic dependence on Moscow, or to force these companies to turn to other export channels instead of the Druzhba and thus evade the transit countries. Finally, according to the agreement following a three-month transportation delay, Belarus abolished the transit tariff, whereas Russia imposed a minor export tariff on the crude oil to be refined, the extent of which was $53 in 2007, corresponding to 29.3% of the effective export tariff for crude oil, while the total $180.7 sum was retained for re-export. It was separately stipulated that Russia should receive an increasing share in the export tariff of oil products refined in Belarus – 70% in 2007, 80% in 2008 and 85% in 2009 (Weiner, 2008: 133, 154).

In a typically resource-based economy, natural resources account for more than 10% of GDP or gross value added and 40% of exports (Kalyuzhnova, 2008: 7). Within the CU, it is the Kazakh economy that relies most heavily on mineral wealth, especially on crude oil and natural gas. Russia is also highly dependent on these resources but has a larger manufacturing industry (see Tables 3 and 7). *Russia and Kazakhstan are strategically important to world energy markets, attracting considerable amounts of FDI.* The hydrocarbon sector of Kazakhstan in particular played a crucial role in the recovery from transitional recession and attainment of a high rate of economic growth. Both the Russian and Kazakh economies have a high export concentration in mineral resources, which makes them particularly vulnerable to price fluctuations in world commodity markets. This leads to a concentration in specific markets, which again highlights a significant dependence on external factors, the Russian crisis of 1998 being a major example (Kalyuzhnova, 2008: 7, 10–12; Simon Jr. 2008: 3, 8–9). At the same time, in Kazakhstan the rise in world oil prices coincided with new oilfields

coming into production and easing transport problems. Thus, the oil boom of the twenty-first century provides the country with a golden opportunity to overcome the errors and missed opportunities of the crisis decade of the 1990s (Pomfret, 2005: 872).

Table 8. Imports in percentage of exports by main commodity groups

Commodity group	2000				2008			
	BY	KZ	RU	*CU**	BY	KZ	RU	*CU**
Agricultural products	62.0	143.3	81.3	*95.5*	77.1	100.0	73.0	*83.4*
Fuels and mining products	52.1	885.0	1840.5	*925.9*	80.9	956.5	2812.2	*1283.2*
Manufactures	115.0	39.3	79.6	*78.0*	89.5	35.2	39.0	*54.6*
Total trade turnover	85.5	172.9	232.2	*163.5*	85.0	190.6	160.9	*145.5*

* Average.

Calculated from Table 7.

As seen from Table 8, since the turn of millennium, the Customs Union's total trade has been closed with huge surpluses owing to the favourable trade balances of Russia and Kazakhstan (Belarus' trade deficits were not able to alter the picture). In the total CU, between 2000 and 2008 there was a nearly one and a half-fold increase in the trade surplus for fuels and mineral products. At the same time it was a negative trend that the coverage of imports by exports became even less insufficient for agricultural products and especially manufactures.

In Soviet economic policy, oriented chiefly towards the domestic market, there were two levels of import substitution – the first inside the USSR and the second within the Comecon. Export prices for oil and gas from the first oil shock to perestroika were definitely, though not always equally, favourable. A much bigger problem was the fact that most of the hydrocarbon exports went to the Comecon countries at specific internal prices. In today's Russia, the recovery of the Putin era (2000–2008) was based considerably and, by some estimates, exclusively on enormous and constantly increasing revenues from energy carrier exports (Simon Jr., 2008: 8–9).

In Delyagin's (2005: 75–82) and many other researchers' opinions, *the model of economic development based on raw material exports has already exhausted itself* (For discussion on this question, see Köves, 2005). In this context, Kalyuzhnova and Nygaard (2008) analysed the connection between resource nationalism and financial sector intervention in Russia and Kazakhstan. They found that

the hydrocarbon sector boosted domestic credits through a number of direct and indirect routes. However, sovereign wealth funds that were established in a majority of energy rich emerging economies may, to the extent that they enable the selection of winners in specific economic sectors, create path dependency or exacerbate longer term allocative inefficiency arising from the governance structure associated with resource nationalism.

5. CONCLUSION

The idea of a customs union among the successor states of the former USSR was first envisaged for the entire CIS, but then narrowed to the EURASEC. Of the sub-regional groupings in the post-Soviet space, it is currently the latter organisation that can be considered as most successful, though transition to a harmonised policy within this community, including the richest and poorest countries of the CIS, seems quite a long process. The Common Economic Space, because of Kiev's refusal to move beyond a free trade area, has not justified the original hopes, remaining merely an interesting large-scale project.

The process of forming a customs union within the EURASEC has not yet finished. The foregoing results have not helped diversify the economic structure of its member states and lessen their import dependence. Thus, the author's hypothesis has not been corroborated. Moreover, it has been revealed that the declining level of intra-trade does not augur well for the future of this grouping, while the situation is further complicated by a negative impact of the present global crisis on the economy of its participants and increasing geopolitical rivalry in the region.

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Received: *December 22, 2009*

Accepted: *March 17, 2010*