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The Customs Union of Belarus, Kazakhstan and Russia: a way to strengthen Moscow's position in the region*

In mid-2009, Russian Prime Minister Vladimir Putin gave new impetus to the launching of the Customs Union between Belarus, Kazakhstan and Russia, and has consistently supervised its implementation ever since. The development of a common trade policy towards third countries and the abolition of tariff and non-tariff barriers in internal trade was intended to initiate the free movement of goods in the area. In the following months, the parties agreed on deepening the integration within the framework of the Common Economic Space, which was meant to bring about three more freedoms: free movement of services, capital and labour. Vladimir Putin has set a very limited time frame to implement these objectives. The common external tariffs came into force in the three countries on 1 January 2010. The Common Customs Code came into force on 1 July 2010 between Russia and Kazakhstan, and was joined by Belarus on 6 July. Moreover, in May 2011, the Customs Union members agreed that if any of the countries joins the World Trade Organization (Russia became its member in August 2012), its commitments to WTO will be incorporated into the legal base of the Customs Union. The Common Economic Space was formally launched on 1 January 2012.

General principles of integration

The integration within the **Customs Union** has proceeded largely under the conditions imposed by Moscow. The **common import tariff** that was introduced, coincides in 80% with the import duties that were in force in Russia. This forced Kazakhstan to raise its tariffs, and lift the weighted average rate from 6.2% to 10.6%. In the case of Belarus, whose import tariff was unified with the Russian one in 90%, the changes were much less significant and involved selected goods, such as cars. In order to reduce the negative consequences of the common tariff introduction, Kazakhstan and Belarus have negotiated a list of products (over 400 items) that were excluded from the common regime during the transition period. Among

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Abstract

In mid-2009, Russian Prime Minister Putin gave new impetus to launch the Customs Union and the Common Economic Space between Belarus, Kazakhstan and Russia, and has consistently supervised its implementation ever since. The Common Import Tariff and the Common Customs Code were introduced in 2010. Formally, the Common Economic Space began functioning on 1 January, but the progress in the implementation of its principles is limited.

From the Russian perspective regional integration has mainly political significance. Tightening relations within the CIS was to counteract the economic expansion of third countries (e.g. China or the European Union) and prevent Moscow's ties with the CIS countries from loosening.

For other the CIS countries, the integration with Russia – which is dominant partner in terms of political, economic, military and geographical potential – poses a threat of becoming totally dependent on Moscow.

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the exclusions (in force until no longer than 2015) there were vehicles, furniture, medical diagnostic equipment, pharmaceuticals and aircraft.

Export duties, which were most commonly used by Russia (imposed primarily on energy resources, scrap metal and timber - crucial export's goods of Customs Union's countries) have been completely excluded from the common customs tariff regime. What is important, however, export duties have not been fully lifted even in the internal trade of the Customs Union. For example, Moscow imposes this duty on the oil sent to Belarus, which is not intended for this country's needs. Since 2012, only the supplies of oil to the Customs Union members delivered via pipelines will be exempted from customs duties. Moreover, Russia has announced that as of 2014, it would impose duties on the entire volumes of oil sent to Kazakhstan.

The introduction of the **Common Customs Code (CCC)** was designed to set uniform principles for all member states, concerning tariffs, non-tariff regulations, customs control, and all customs procedures related to import, export and transit of goods. Customs Union's Code has been based on the International Convention on the Simplification and Harmonization of Customs Procedures (signed in Kyoto in 1973) and the requirements of the WTO. This document has introduced facilitations of the clearance of goods sent across the external borders of the Customs Union, reduced the duration and number of documents required for these operations. The introduction of CCC in the internal trade of the Customs Union has abolished the customs clearance of goods originating in the Customs Union states and third countries, that have been cleared by customs services of any Customs Union member. Also, customs control points have been withdrawn from internal borders of the Customs Union. They disappeared from the Russian-Belarusian border on 1 January 2011 (although the Belarusian side insists that Russian customs officers returned to the border crossings with Belarus in early 2012), and half a year later they disappeared from the Kazakh-Russian border (1 July). The Code has been prepared quite hastily, therefore not all the details have been negotiated and the document contains many references to national law of the integrating states. Not all the necessary executive acts have been prepared, either. As a result, differences remain in some customs procedures of the three countries. The new Code is now being prepared, to remove the numerous shortcomings of the existing document.

Formally, the **Common Economic Space** began functioning on 1 January 2012, even though most of the executive acts necessary for implementing its principles had not been agreed. Works on the necessary documents and their implementation according to agreements are to last until 2015, and in some cases the transition periods may be completed only in 2020. According to the principles of the Common Economic Space, Russia, Kazakhstan and Belarus plan to harmonize their economic policies, including: agreeing on uniform principles of access to the services of natural monopolies, standardization of the competition policy, and harmonization of the services market. The parties have also declared they would introduce the free movement of capital and labor, harmonize the monetary, energy and transport policy, as well as standardize technical requirements on goods.

So far, within the framework of the Common Economic Space, Russia, Belarus and Kazakhstan have managed to implement the **free movement of labor**. Workers from these countries do not need to apply for special work permits and should be treated as nationals (identical working conditions to those that apply to the given country's citizens). However, the **free movement of goods** has not been fully implemented as yet. Although the majority of tariff barriers have been abolished, many non-tariff barriers continue to hamper trade. This applies mainly to existing differences in technical requirements or the need to apply the national legislation in the absence of common solutions.

The progress in the implementation of **free movement of capital** is also modest. The main stage of harmonization of legislation concerning the banking and foreign exchange market, securities and insurance, is to take place only in late 2013. The whole process is to be completed only by 2020. The progress in the implementation of the **free movement of services** is also limited. National

regulations of the country in which the service is performed still continue to apply. The parties have only agreed that they would try to offer their partners access to the market on national principles. However, many services have been excluded from this regime, such as audiovisual services and air transportation services. In addition, the list of exceptions may be extended by each country individually (e.g. Kazakhstan has reserved the right to decide on strategic natural resources).

Managing the process of integration

Responsibility for the integration process rests on the appointed bodies of the Customs Union and the Common Economic Space. The main body is the **Supreme Eurasian Economic Council** that meets once a year at the level of heads of state, and at least twice a year at the level of prime ministers. The council sets the strategic directions of the cooperation. This body also has a decisive voice in contentious issues relating to the integration process.

The organ that is crucial to the effectiveness of the integration process is the Moscow-based **Eurasian Economic Commission** – permanent, supranational body of the Customs Union and of the created Common Economic Space (the equivalent of the European Commission in the European Union). Its task is to manage the integration process on a daily basis, and to develop legal solutions that enable the implementation of the provisions of the signed documents. The scope of competence of the Commission depends on the degree of actual integration of these countries. At the moment, this organ is responsible primarily for customs and tariff policy. The decisions accepted by the Commission become an integral part of the legal base of the Customs Union and the Common Economic Space, and do not need to be ratified. These decisions are implemented by the member states' authorities.

The **Court of the Eurasian Economic Community** is the body that settles economic disputes and ensures that the parties respect the signed agreements. This authority was launched in January 2012, it consists of six judges – two representatives from each state. The rulings of the Court are binding for the member states.

The importance of the integration process for Russia

From an economic perspective, the Commonwealth of Independent States (CIS) area has a limited importance for the Russian economy. This area accounts for less than 14% of Russia's trade and less than 1% of Russian investments. Russia's economy is much more closely tied to the European Union, which is its largest trading partner, main investor and a major source of investment goods and technologies necessary for economic modernization. However, the CIS economic integration on Moscow's terms increases the competitiveness of Russian products in this area at the expense of exporters from third countries, mainly the European Union and China.

It seems, however, that for **Russia** regional integration has mainly political significance. Tightening relations within the CIS has become one of the priorities of Russian foreign policy in recent years. From Russia's point of view, regional integration was to counteract the economic expansion of third countries and prevent Moscow's ties with the CIS countries from loosening. Regional co-operation has become one of the platforms of Moscow's competition with the European Union for influence in the former Soviet Union's European countries, especially Ukraine and Moldova. On the other hand, strengthening Russia's presence in Central Asia was aimed at balancing China's growing activity in the region.

At the same time, closer regional cooperation was to guarantee Russia the maintenance of strong political and economic influence in the area, especially in the energy sector, which determines the importance of this region to the global economy. That is why Russia seeks to include all CIS countries in the regional integration structures, especially Ukraine – the second largest economy of the region. Russia does this with great determination, using all the instruments it has at its disposal.

Representatives of the Russian ruling elite have repeatedly warned Ukraine that if Kyiv does not join the Customs Union, Russia would block their access to its market.

One of the reasons behind Russia's determination to push through the integration process, is that Moscow sees the strengthening of its position in the region as a way to raise its significance in the international arena. The integration of potentials of the CIS countries (raw materials, capitals and human potential), as presented by Vladimir Putin in some newspaper articles (e.g. *Süddeutsche Zeitung*, 25 November 2010), was to increase the competitiveness and attractiveness of the area, upgrading its position in the global economy. In the future, the integrated CIS region could strengthen cooperation with the European Union by creating a common economic space from Lisbon to Vladivostok. The partnership of these two integration structures would create a real environment for geo-political and economic changes on the continent, which would also have an effect of global importance.

Regional integration was also important for Russia's image – Moscow needed the success of this process to demonstrate that it remains the center of attraction for the CIS, capable of effectively taking the initiative in the post-Soviet area. Russia also wanted to show that it is an independent player on the international stage, able to build its own regional groupings, similar to those created in other regions of the world (the EU, NAFTA, ASEAN, MERCOSUR).

The importance of the integration process for the remaining countries in the region

For other countries, integration with Russia – which is a dominant partner in terms of political, economic, military and geographical potential – poses a threat of becoming totally dependent on Moscow. This anxiety is strengthened by the fact that Russia has repeatedly demonstrated that it is not willing to compromise.

For **Kazakhstan**, the cooperation with Russia is of strategic importance, therefore Astana cannot and has never allowed itself to openly oppose Russian policies. Kazakhstan's involvement in the Russian integration project, despite its rather unappealing conditions, was an expression of this policy. Moreover, by strengthening its relations with Moscow, Astana also sought to protect itself from economic and political expansion of Beijing and to balance it with cooperation with Russia. The last decade saw growing economic involvement of China in Kazakhstan. In this context, the establishment of the Customs Union can be seen as a tool that should help Astana channel its cooperation with China and give it the form desired by Kazakhstan (for example, it may help to protect the country against the flood of cheap Chinese production, or to negotiate better terms of cooperation in the energy sector). The interest of Astana, who has two powerful neighbor countries, is to maximize the benefit of the cooperation with both partners, while preventing any of them from dominating the Kazakh economy.

Another Astana's objective was to facilitate its access to the Russian market (about 18% of Kazakh exports go to Russia). The lifting of trade barriers with Russia was to contribute to the growth of Kazakh exports (mainly related to the sectors of metallurgy, coal, chemicals and agriculture) and increase the flow of investments into the country. Kazakhstan's investment climate is much more attractive than the Russian and Belarusian ones (which is confirmed by the *Doing Business 2012* ranking of the World Bank). Therefore Astana expected that businesses will want to take advantage of the opening opportunities and move their production to Kazakhstan, and via this country access the markets of the entire Customs Union. On the other hand, the integration principles set by Russia meant that the tariffs on goods from third countries would be raised, which would increase their price; another risk was the dependence on imports from Russia. This may adversely affect the diversification of Kazakhstan's economy, which is dependent on the raw material sector.

For **Belarus**, which is in conflict with the European Union and dependent on Moscow both politically and economically, there was no alternative than to join the Russian-initiated integration

process. On the one hand, Moscow has many instruments of pressure on Minsk, and has used them repeatedly to force the decisions that were favorable for Russia. For example, the Kremlin has reduced gas supplies to Belarus and threatened to impose export duties on gas, thus forcing Minsk to implement the Joint Customs Code. Moreover, President Alexander Lukashenka's support for the creation of the Common Economic Space was forced by sustaining duty-free supplies of Russian oil to Belarus.

On the other hand, Moscow is one of the few allies of the Lukashenka regime; by supporting the current economic model in Belarus, Russia has become the guarantor of the stability of this regime. By joining the integration process, Belarus has kept Russian loans and subsidies, including preferential prices of energy resources, which are crucial to its economy.

By abolishing barriers to trade with the Russian Federation, Minsk has also gained easier access for its goods to the Russian market (46% of Belarusian exports go to Russia). For some of Belarusian industries this was of fundamental importance: over 90% of food production exports and about 70% of machine exports go to Russia. Like Astana, Minsk hoped that the removal of trade barriers would increase the investment attractiveness of Belarus. Foreign exporters and investors could use Belarus with its more convenient business environment as a "window" to the Russian market. However, the full opening of the Belarusian market to imports from Russia, posed a risk to some Belarusian industries of losing the market for more competitive production from Russia. In the long term, opening up for the Russian capitals and goods may lead to the deconstruction of the current command-and-distribution model of the Belarusian economy.

Kyrgyzstan and Tajikistan in fact remain far beyond the integration process. These countries, with their weak economies, are anxious about being dominated by stronger partners: Russia and Kazakhstan. Formally Kyrgyzstan argued that it is a member of the WTO and has to comply with the principles of this organization. If the duties of this state were to be changed, Kyrgyzstan would be required to offer costly compensation to its WTO partners, for whom the conditions of access to the Kyrgyz market would deteriorate. Bishkek would be incapable of providing such a compensation. In addition, before the establishment of the Customs Union, Kyrgyzstan used to re-export Chinese goods to other CIS countries, mainly through Kazakhstan. Therefore it feared that the accession to the Customs Union would block this practice and reduce its income. As it turned out, not joining the Customs Union also had a negative impact on the Kyrgyz economy. Due to the strengthening of the Kazakh-Kyrgyz border control, which has become the external border of the Customs Union, the possibility of re-exports of Chinese goods has seriously decreased.

Tajikistan, in turn, officially declared its desire to join the Customs Union, but it argued that this would only be possible when it would have a direct border with the rest of the Customs Union, i.e. after Kyrgyzstan joins this organization. Even though these two countries were marginal for the effectiveness of the integration process, Russia has consistently persuaded Kyrgyzstan and Tajikistan to join it. Bishkek declared its desire to join the Customs Union in April 2011, Tajikistan has also announced its intention to become a member.

For **Ukraine**, the accession to the Customs Union would in fact mean the abandonment of integration with the European Union and the model of modernization based on its western neighbor. Joining the Customs Union and the common trade policy towards third countries, would bring the necessity to agree with Moscow its terms of cooperation with the EU. This decision would also be an important political statement and the choice of the "Russian option". Ukraine is trying to avoid this, by offering cooperation with the Customs Union, albeit with no formal commitments.

From Kyiv's perspective, the most favorable option would be to balance between the two most important political and economic partners and making the best use of the cooperation with both of them. However, Russia has sufficient instruments (such as gas supplies, or restrictions of the access to its market for Ukrainian exporters) to influence Ukraine. There is no guarantee that Ukraine will be able to resist the Russian pressure.

Conclusions

Since the collapse of the Soviet Union we have witnessed a progressive economic disintegration of the Commonwealth of Independent States. Despite numerous attempts to restore close economic relations in the area, including hundreds of multilateral and bilateral integration agreements, effective economic structures have not been created, while trade exchange between post-Soviet countries has been losing importance. At the same time, the role of partners from outside the region was increasing: the European Union, China, Iran and Turkey. The increasing activity of third countries in the CIS area raised Moscow's concerns, as it considered this area as its sole sphere of influence. The Russian integration initiative launched in 2009 was aimed to counteract this process. Even though the integration process has so far involved only three countries (Russia, Belarus and Kazakhstan), the Customs Union is still the most effective structure that has emerged in the area since the collapse of the Soviet Union.

It is unlikely that the establishment of the Customs Union and the Common Economic Space, even in the case of Ukraine's accession, will seriously boost the economic attractiveness of the region, contributing to the increased inflow of investments and rapid economic development. The existing principles of operation of the integration structures, the way of their implementation (poor quality of the legislation, no executive acts, failing to carry out the information policy) are not a sign of substantial liberalization of trade and investment climate. This is because the integration process is aimed at restricting the competition on this market, rather than at modernizing the economies of the region.

Russia's interests and determination suggest that the integration process will continue. There are doubts, however, whether the parties will be able to accomplish all the objectives of integration. The limitation of powers of national institutions results in resistance by Belarus and Kazakhstan, as evidenced by previous conflicts. It can be expected that the attempts to deepen the integration will create ever more severe disputes and result in extending of that process.

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