Remarks on the Eurasian Economic Union

William Courtney
U.S. Ambassador (Retired)
President, U.S.-Kazakhstan Business Association

Delivered at the international conference on
Central Asia and the Eurasian Economic Union:
The Global Picture and Country Perspectives
Central Asia Program, IERES
The George Washington University
February 26, 2015

An independent, non-profit organization, the US-Kazakh Business Association represents U.S. firms doing business in Kazakhstan. We work with partners to foster a positive business and investment climate, which helps companies to be productive and the country to grow and prosper. In part by leveraging its foreign investment, Kazakhstan has become deeply embedded in the global economy. Productivity and incomes have grown sharply. TengizChevroil is one of the largest and most successful investments anywhere in Eurasia. Let me first describe the Eurasian Economic Union, or EEU. Then I will address policy issues related to its future.

The Eurasian Economic Union

Eurasian economic integration has evolved over the past two decades. In 1994 the President of Kazakhstan, Nursultan Nazarbayev, proposed the creation of a regional trading bloc. In the 1990s and 2000s Belarus, Kazakhstan, and Russia, sometimes along with other post-Soviet states, ratified several treaties to promote regional economic integration, but the only effective institution is the Customs Union between the three countries, launching in 2010. The Customs Union seeks to
eliminate tariff and non-tariff barriers among members, establish a common external tariff, and value imported goods in a unified way. The external tariff, which is aligned with Russia’s, is relatively high, and this will hurt economies in the Union. Kazakhstan has gained relief from high tariffs in a couple of key areas, such as aircraft.

In November 2011, Belarus, Kazakhstan, and Russia agreed to upgrade the Customs Union to an Economic Union, an entity in which there is greater coordination of national economic and other policies. In 2012, the three states established the Single Economic Space, to give more impulse to the single market for goods, services, capital and labor, and to improve coordination of industrial, transport, energy and agricultural policies. Last month the Eurasian Economic Union, or EEU, came into force. It encompasses Armenia, Belarus, Kazakhstan, and Russia. Kyrgyzstan is expected to join in May.

Success of the EEU will depend on the extent to which it reduces the role of politics in commerce, and increases fair, rules-based regulation that promotes market competition and efficiency. Bureaucratized regulation will benefit smaller players. WTO participation by member states reinforces the EEU’s rules-based operations.

Kazakhstan has a strong interest in regional economic cooperation and unfettered transportation across the Eurasian continent. The EEU’s Eurasian Development Bank, located in Almaty, makes investments to spur economic growth and intra-Union trade, and fund projects that further Eurasian integration. The Bank has provided financing of more than $4.5 billion.

In 2013 the four current EEU members had a combined GDP of just over $4 trillion, according to World Bank data using the purchasing power parity method. Russia contributed 86% of the total GDP. EEU member states produce about one-fifth of the world’s natural gas, and one-seventh of global oil and gas condensate. Member states are planning common electricity and hydrocarbon markets.

The EEU has the world’s second-largest amount of railway trackage. In response to rising demand for rail transport, the Eurasian Development Bank plans to finance the construction of facilities to produce freight cars and containers.

Russia is using several inducements to persuade neighbors to join the EEU. Member states qualify for subsidized gas prices, which, for Belarus, is a major incentive. Last April as Kyrgyzstan pledged to join the Union, Gazprom bought the country’s gas network and pledged “a stable gas supply.” In August Foreign Minister Sergei Lavrov announced that Russia would provide $500 million to speed up Kyrgyzstan’s integration into the Union.

In September 2013 after stiff Russian pressure, Armenia opted to join the Union and abandon hopes for an EU Association Agreement. Georgia and Moldova have resisted Russian pressure. Like Ukraine, they have concluded EU Association Agreements. The five Russian-occupied separatist regions in those countries—Transnitria, South Ossetia, Abkhazia, Nagorno-Karabagh, and of course Crimea—however, will have access to the EEU through Russia.

Policy Issues

Let’s now look at some of the major EEU policy issues.

A voluntary, rules-based Union. In December 2012 then-U.S. Secretary of State Hillary Clinton described Russian efforts to promote Eurasian integration as “a move to re-Sovietize the region.” Referring to the Eurasian Customs Union she said, “we are trying to figure out effective ways to slow down or prevent it.” Time has moved on. The EEU is becoming real, and the U.S. government does not oppose its creation. To the extent that the Union becomes a
voluntary, rules-based organization, it is more likely to promote economic efficiency and opportunity.

Russia’s use of force to challenge Ukraine’s European choice is an ill omen for future EEU governance. Moscow should realize that if it wants the Union to succeed and endure, the EEU must be fairly governed and rules-based, and in the main eschew politics.

**Economic Productivity.** An economic union should boost productivity, or efficiency, by reducing barriers to trade and investment, and by improving economic policy coordination. There is uncertainty about the extent to which these benefits will accrue.

The noted economist Anders Aslund cautions that, “since Russia is comparatively protectionist, any country that joins the current Customs Union is compelled to raise its custom tariffs, which leads to trade diversion that reduces economic welfare.” This is a serious concern. Offsetting these costs will be those gains that result from the reduction of trade barriers within the Union.

Coordination of economic policies of EEU member states is not yet apparent. Russia took decisions last August to ban most food imports from the West, and last November to float the ruble, with no evident consultation with prospective EEU partners even though they are affected. Belarus and Kazakhstan rejected participation in the food import ban. It may benefit Belarus, which is now supposedly “exporting” Parmesan cheese, salmon, and oysters to Russia.

**Currency.** Last July Russia’s First Deputy Prime Minister Igor Shuvalov predicted that the EEU would have a common currency within a decade. This seems unlikely. Russia’s intervention in Ukraine and its food import ban remind EEU member states of the risks of tying their economies closely to Russia’s. Moreover, the struggles in the Eurozone show that the risks of creating a single currency absent coordinated fiscal policies. Member states are sensitive to their sovereignty and may be reluctant to cede fiscal control to an EEU executive authority.

In any economic union, flexible exchange rates smooth adjustments, increase efficiency in the foreign exchange market, and reduce pressures on central banks to waste money defending rates not validated by the market. Flexible rates also help governments deflect blame for changes that may be unwelcome to some market participants or the public at large. Last fall Russia wisely moved to flexible rates. Other EEU member states have not yet done so.

**Visas.** Kazakhstan has a more liberal approach to visas than does Russia. Astana allows visa-free travel by citizens of ten countries, including six of the seven G-7 countries. After this year only citizens of member states will be allowed to travel within the EEU on an internal passport. Citizens from non-member states will need visas. Russia and Kazakhstan absorb substantial migrant labor from other Central Asian countries, which count on remittances for a major part of their GDP. The visa requirement will hurt these laborers, and harm economic productivity in areas of the Union that suffer from worker shortages.

**New Silk Road.** A growing part of the New Silk Road is east-west rail transport through the EEU between Europe, and Russia’s Far East and China. Key components are the Trans-Siberian Railway, overland routes that traverse Kazakhstan, and Siberian and Caspian energy pipelines.

Emerging rail routes will cut transit times across the Union by up to two-thirds versus shipping by sea. This will be attractive for the shipment of some higher-value goods. There will also be opportunities for better north-south routes. EEU countries ought to leverage best practices from the Northern Distribution Network and find ways to lower its costs in order to
make these channels competitive. The Union can make a real difference if it improves transport infrastructure and spurs trade-transit agreements that speed up border crossings.

Over time Kazakhstan will capture more trans-Eurasian cargo traffic. Some industries along China’s eastern coast are moving labor-intensive work to the interior, where wages are lower. Many products produced there will be exported to Europe by rail through Kazakhstan. The Chinese may put more assembly facilities, such as for computers, in a free economic zone at Khorgos, and then ship them to and through Kazakhstan, Russia, and beyond.

**Reform.** Further economic reforms will reinforce potential benefits from the EEU. Market-driven economic diversification will become important in Kazakhstan and Russia as they seek to reduce relative reliance on energy production and exports. Acceleration of reforms, such as privatization and better economic regulation, will stimulate investor interest and reduce opportunities for corruption. At present the predominant role of the state in EEU economies enhances political interference and acts as a drag on growth and productivity.

**European Union.** Last July Putin said he was ready to discuss a free-trade area between the European Union and the EEU. The Russian intervention in Ukraine now forecloses this option, perhaps for a long time. Kazakhstan’s new Enhanced Partnership and Cooperation Agreement with the EU is comprehensive. Along with future WTO membership, it will help ensure that Kazakhstan remains open and engaged with the West in trade and investment.

**China.** China’s economic power in the EEU space is increasing, especially in Kazakhstan. Over time, trade and investment between Kazakhstan and China will grow substantially. It will be important that the Union not impede these ties. In September 2013, the presidents of China and Kazakhstan signed a number of commercial deals and launched China’s ‘New Silk Road.’ Last May they spoke of linking Kazakhstan’s railway system to the Pacific Ocean via a new terminal in Lianyungang. The two countries plan to invest $1 billion to modernize an oil refinery in Shymkent, and $150 million to build a new oil and gas plant near Almaty.

**Belarus.** Frequent trade squabbles between Belarus and Russia undermine confidence that the EEU will be well managed. In 2009 Russia banned the imports of milk and dairy products from Belarus. Last November Moscow banned meat imports. Last month President Alexander Lukashenka, citing “trade wars” within the EEU, said he did “not rule out” quitting it. The threat is mostly empty. Belarus benefits from energy subsidies, although Moscow chafes at these periodically.

**Political Union.** Presidents Lukashenka and Nazarbayev wisely oppose the Kremlin’s aim to infuse the Union with a political role, such as by creating a Eurasian parliament. Nazarbayev has vehemently rejected the EEU’s having any political dimension. Last month Lukashenka reiterated that Belarus stood opposed to any political role, such as a common visa regime. As a Kazakhstani EEU negotiator put it, “We do not meddle in what Russia does politically, and they cannot tell us what foreign policy to pursue.”

**Sanctions.** Media reports say the West may increase sanctions on Russia’s energy or financial sectors. Any new sanctions, if not targeted, could lead to more collateral damage to non-Russian EEU member states. Western policymakers should take this risk into account. Extreme options, such as removing Russia from the SWIFT international payments system, would do great harm to Russia’s neighbors.

**WTO for Kazakhstan.** Negotiations for Kazakhstan’s entry into the World Trade Organization are in a final phase. WTO membership will assist Kazakhstan to conduct international commerce based on transparent, depoliticized rules. In anticipation of EEU and WTO partic-
ipation, Kazakhstan is building certification laboratories. They will aid the export of automobiles, machinery, food, clothing, and other products.

In conclusion, the EEU can play a useful role across the Eurasian continent if member states make the Union a force for economic efficiency and lower trade barriers. A vibrant EEU could increase the competitiveness of all participating economies. Integration will yield the most dividends if the Union's decisions are based on long-term economic interests, and not on short-term political maneuvering.