

The Eurasian Economic Union. Analysis from a trade policy perspective

- Financed by the Federal Ministry for Economic Affairs and Energy -

Second version: 8 September 2017

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1. Subject of this presentation

EAEU covers several aspects of regional integration (“4 freedoms”)

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

Focus here: Trade

- Trade within the EAEU (“internal trade”)
- Trade with third countries (“external trade”)

Thus

- Analysis does not cover all aspects of integration
- But: Trade is as of today by far the most important aspect of integration

2. The economic size of EAEU member countries

	GDP		Population		GDP per capita
	USD bn	% of EAEU	m	% of EAEU	USD
Russia	1,281	87%	143.4	80%	8,929
Kazakhstan	134	9%	17.9	10%	7,453
Belarus	49	3%	9.5	5%	5,143
Armenia	10	1%	3.0	2%	3,511
Kyrgyzstan	7	0%	6.1	3%	1,073

Source: IMF, Eurasian Economic Commission, Data for 2016

- Dominant role of Russia
 - 87% of EAEU GDP
 - 80% of population
- *Comparison EU: DEU is the largest member; 27% of GDP and 16% of 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 size of the EAEU in international comparison

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

Country / trade bloc	Trade volume, USD bn, 2016	% of world trade
USA	3,703	13.1%
China	3,686	13.0%
EU-28	3,454	12.2%
Japan	1,252	4.4%
South Korea	902	3.2%
Canada	792	2.8%
India	617	2.2%
EAEU	509	1.8%
Mercosur (BRA, ARG, etc.)	405	1.4%
Turkey	341	1.2%
South Africa	149	0.5%

Source: UN Comtrade, Eurasian 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 6.6% in world energy trade

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

5. Relevance of the EAEU for the EU's external 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

- 2016: EU-EAEU trade decreased by more than 40% compared to 2013
 - Implication: EAEU became the fourth largest trade partner of the EU after Switzerland
 - However: EU-EAEU trade increased by 32% in 5M-2017
- EAEU is an important trade partner of the EU & might recover the third place in 2017

6. Level of tariff protection of the EAEU

Average trade-weighted tariff, 2015

Kazakhstan	7.3%	Moldova	4.3%
Russia	5.9%	Ukraine	2.5%
Belarus	4.5%	Georgia	1.7%
Armenia	4.6%	EU	3.0%
Kyrgyzstan	7.7%	USA	2.4%

Source: WTO World Tariff Profiles

→ High tariffs in the EAEU; only minor reduction scheduled (due to WTO commitments RUS)

Furthermore: 3 members increased/will increase their tariffs, because of EAEU/CU accession

- 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 EAEU accession

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

→ Acceding countries had to raise import tariffs; protectionist character of EAEU

7. 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 non-tariff protection of the EAEU, in addition to its tariff protection

8. Implementation of the common internal market

Many exemptions from the Single Customs Tariff (SCT)

- Exemptions for approx. 3,000 goods, which equals around 1/3 of tariff lines
- Implication: Border controls necessary in internal trade, creating costs

Non-tariff barriers (NTBs) in internal trade

- Research by EDB Center for Integration Studies (2015): NTBs are very costly
- Empirical result: NTBs cause costs in a range of 15-30% of total export value
- Reasons: Problems with 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, MDA

- 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)

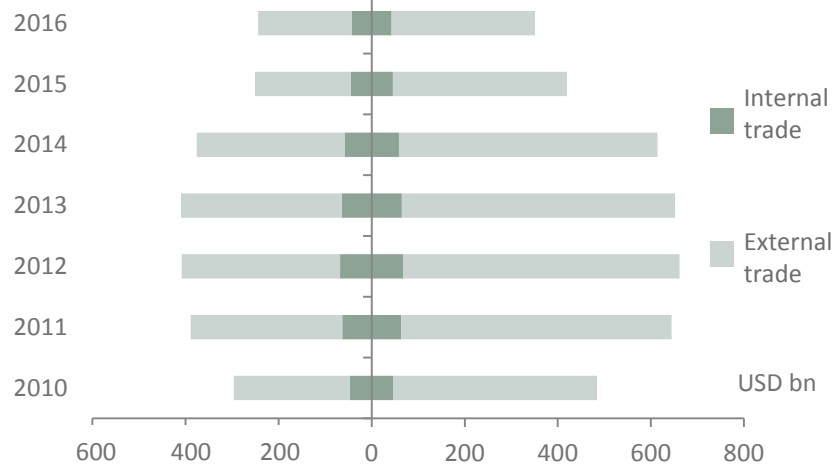
→ **Substantial trade barriers on the “common internal market“**

9. Internal trade vs trade with third countries

EAEU

Imports

Exports

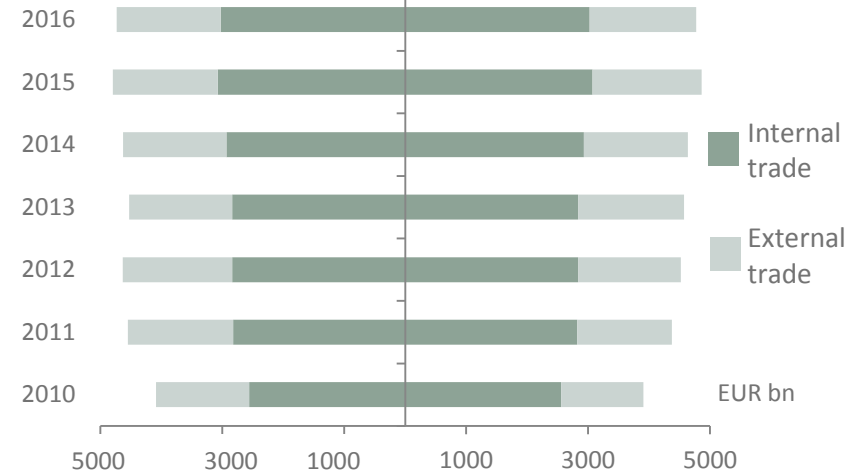


Source: Eurasian Economic Commission

EU

Imports

Exports



Source: Eurostat

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

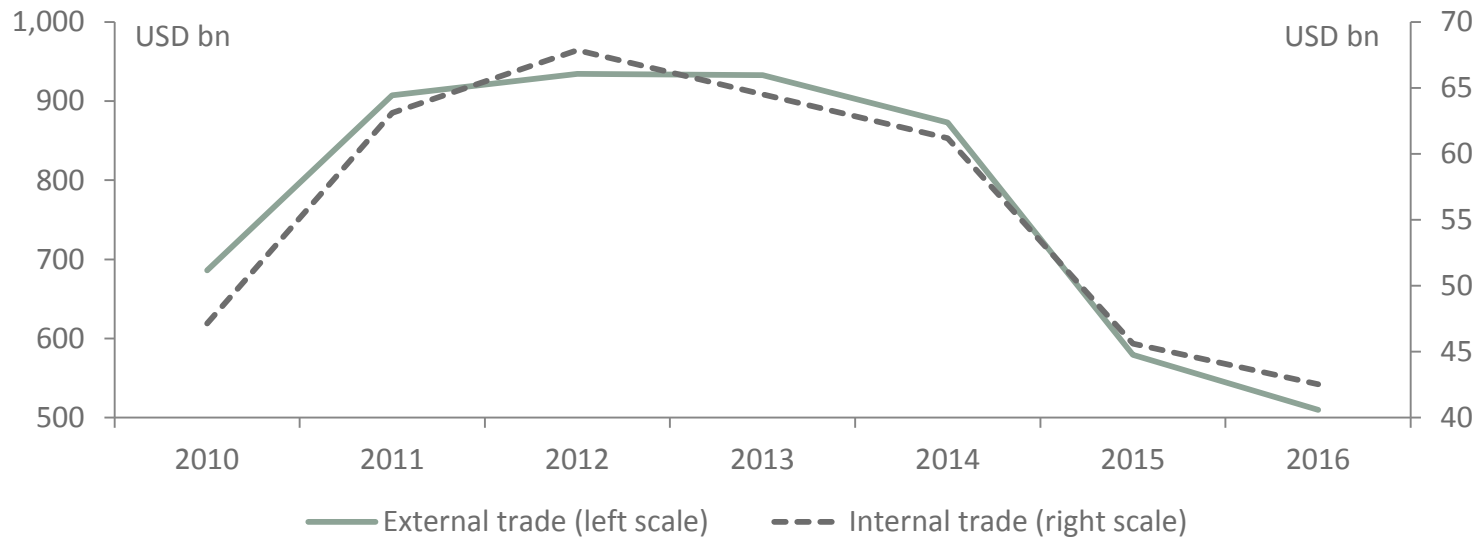
2016: 88% of total exports to third countries, 83% of imports from third countries

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

Interpretation

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

10. Development of internal trade since the EAEU establishment



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

Internal trade

- Strong decline in 2015 and 2016, i.e. in the first two years of the EAEU
- Main reason: Economic crisis in Russia due to oil-prices and western sanctions
- Furthermore: Internal trade did not outperform trade with third countries, despite the establishment of the EAEU

→ No positive impact of EAEU on internal trade

11. Structure of internal trade by countries

		Importing country, USD m, 2016					
Exporting country, USD m, 2016		ARM	BLR	KAZ	KGZ	RUS	EAEU
	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
- Further 30% between Russia and Kazakhstan
- Only 2% of total trade between Belarus and Kazakhstan

→ **Belarus and Russia are strongly integrated;**
otherwise the economic integration within the EAEU is rather limited

12. Implications of EAEU membership on Russia

Impact of Customs Union (2010) on Russia

- Kazakhstan took over high Russian import tariffs
- In such a way: High protection of domestic market maintained and significant advantage for exports to KAZ

Thus: Positive impact

Additional impact of EAEU (2015)

- Armenia and Kyrgyzstan take over Russian import tariffs

Thus: Additional positive impact

But: Positive impact is rather limited

- Russia accounts for 87% of the Union's GDP
- No decisive extension of the domestic market

→ **Positive, but rather limited impact on Russia**

13. Implications of EAEU membership on Belarus

Belarus

- 96% of exports to EAEU-members are destined to Russia
 - Almost 100% of imports from EAEU-members originate from Russia
- From the Belarusian perspective, the EAEU is not much more than Russia

Situation before the EAEU

- Belarus was already closely integrated with Russia before the EAEU
- Integration in the context of the Customs Union (2010), but also before
- Integration relates not only to trade, but also to labour and capital markets
- Belarus had free trade agreements with Armenia and Kyrgyzstan

→ Practically no impact of EAEU on Belarusian trade in the short-term;
neither positive nor negative impact

Remark: According to some observers Belarus got significant financial benefits from Russia via different instruments in the context of its EAEU accession; however, this subject is beyond the scope of this presentation

14. Implications of EAEU membership on ARM, KAZ and KGZ

Expected positive impact of EAEU (and Customs Union for KAZ)

- Better access to the markets of member countries
- Higher exports within the EAEU
- However: Deficiencies in the internal market imply that positive impact did not materialise so far

Negative effect of EAEU on ARM/KGZ and of Customs Union on KAZ

- Much higher level of import tariffs; imports of modern technology (e.g. from EU) become more expensive; negative impact on modernisation
- End of independent trade policy
- For ARM: Fully negotiated DCFTA with EU could not be signed
- Goal of trade diversification becomes much more difficult

→ EAEU -in its current shape- has a clearly negative impact on ARM, KAZ and KGZ; previous situation (FTAs) was more favourable for these countries

Remark: Armenia got significant financial benefits from Russia (no export duties on gas and raw diamonds) in the context of its EAEU accession; however, this subject is beyond the scope of this presentation

15. Does the EAEU contribute to regional integration in the CIS?

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

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

On the other hand: Institutional disintegration from 3 countries

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

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

16. Why is the EAEU record on regional integration mixed?

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

- 2 options for DCFTA countries (ARM, MDA, GEO, UKR): Full integration OR trade sanctions/disintegration; “either with or against us“
- Example Ukraine: Membership in Customs Union (incl. loans, special conditions for gas, etc.) OR cancellation of free trade agreement / trade sanctions

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, MDA, 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

Remark: Despite this insight, the EAEU is a reality in international trade policy, to be taken into account

17. Does the Eurasian Economic Commission have full competences?

Eurasian Economic Commission (EEC): Policy competence for negotiations on goods

But: No competence for negotiations on services and investments

Instead: Russia's competence; context: "two tracks" negotiations approach

FTA with Vietnam: Parts on services & investments apply only to Russian companies

On top: Competence of EEC (and of CU institutions before) on goods is ignored by Russia in practice, as soon as key foreign policy/geopolitical issues are concerned

Examples: Many unilateral decisions by Russia in the recent past

- 2014: Import ban for selected foodstuffs from EU/USA ("counter-sanctions")
- 2014: Free trade agreement with Moldova partly suspended
- 2016: Suspension of free trade agreement with Ukraine
- Measures not in consultation with EEC and applied only by Russia

→ EEC competence applies only to goods; limited competence

→ This competence is often overridden by Russia due to geopolitical considerations

18. Is the EEC a suitable negotiating partner for the EU-Commission?

Trade negotiations: Different type of topics

- Trade liberalisation (FTAs, investment, etc.); strategic topics
- Trade facilitation (standards, certificates, customs clearance); technical issues

Trade liberalisation (e.g. EU-EAEU FTA)

- No de facto competence at EEC; not the right partner for the EU-Commission
- However: As of today, this is anyway a hypothetical question, because Russia has no interest in an FTA with the EU

Trade facilitation/technical issues

- EEC has the necessary competence
- Besides: No strong interference/overruling from Russia to be expected, since such issues do not have a strong geopolitical dimension

→ **EEC appropriate partner of the EU Commission for trade facilitation**

Disclaimer: This conclusion is derived from a pure trade policy perspective and does not take into account the current political tensions between the EU and Russia.

19. 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: Persistently 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

20. Conclusions

EAEU in a nutshell

- High level of tariff and non-tariff protection vis-à-vis third countries
- Significant barriers to internal trade; no proper common market
- Contribution of EAEU to regional disintegration in the CIS

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

Closing remarks

- Regional economic integration makes sense, but only if protection is not high and the internal market works smoothly
- EAEU today: Neither of these conditions are fulfilled
- Crucial for the future of the EAEU
 - Reduction of protectionism
 - Removal of internal trade barriers
 - Strengthening of EEC and conclusion of FTAs with large trading partners (so far only one FTA with Vietnam)

→ **EAEU has potential, but it is far from reaching it**

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21. 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?

22. 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