

Евразийский экономический союз между Россией, Беларусью, Казахстаном, Арменией и Кыргызской Республики: Можно ли добиться успеха, где его предшественник не удалось?

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The Eurasian Economic Union among Russia, Belarus, Kazakhstan, Armenia and the Kyrgyz Republic: Can it Succeed where its predecessor failed?

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# From Customs Union to Single Market

- In 2010, Russia, Belarus and Kazakhstan formed the Eurasian Customs Union and imposed the Russian tariff as the common external tariff (CET) of the Customs Union.
- Kazakhstan had to almost double its average external tariffs to implement the CET.
- In 2015, they formed the Eurasian Economic Union (EAEU) designed to create a single market, i.e., promote the free flow of goods, services, labor and capital (in principle).
- In 2015, Armenia and the Kyrgyz Republic joined; they also had to double their external tariffs to implement the CET.

# Outline of the Talk

- 1. Tariff Issues
  - Trade Diversion and the collapse of the earlier Customs Union
- 2. Deep Integration
  - (i) Non-Tariff Barriers
  - (ii) Trade Facilitation
- 3. Stakes for the 5 Member Countries
  - Also considering Migration, Subsidies, Loans, FDI, Military Support
- 4. Conclusions

# Kazakhstan, Armenia and the Kyrgyz Republic all Lose from Costly Trade Diversion

- Estimates reveal that the tariff changes resulted in **substantial transfers from Kazakhstan to Russia**. (Jensen and Tarr in World Bank, 2012.)
- The common external tariff is structured to protect Russian industry.
- Importers in Kazakhstan now purchase lower quality or higher priced Russian imports that are protected under the tariff umbrella of the common external tariff. WTO accession complicates the story.
- And a substantial econometric literature shows that developing countries gain more Total Factor Productivity from trading with technologically advanced countries. Reduced European and US imports cost Kazakhstan in TFP increases.
- Similar impacts should be expected for Armenia (see estimates of Jensen and Tarr, *Economics Open Access Journal*, 2012) and the Kyrgyz Republic.

	Average Tariff prior to joining the ECU		Average Tariff After applying the common external tariff of the ECU in 2010		Final WTO Bound Average Tariff	EAEU average common external tariff in 2020
	un-weighted	trade weighted	un-weighted	trade weighted	un-weighted	un-weighted
Country						
	Tariffs in 2009					
Belarus	12.0 <sup>a</sup>	8 <sup>a</sup>	11.1 <sup>a</sup>	NA <sup>b</sup>	NA <sup>b</sup>	7.9 <sup>c</sup>
Russia	11.9	11.6	11.1	11	8.6	7.9 <sup>c</sup>
Kazakhstan	6.7	5.3	11.1	9.5	6.1	7.9 <sup>c</sup>
	Tariffs in 2013					
Armenia	3.5	3.4			8.5	7.9 <sup>c</sup>
Kyrgyzstan	4.6	4.1			7.5	7.9 <sup>c</sup>

# Transfers of Income to Russia from Central Asia due to the tariff structure caused EurAsEC to fail.

- EurAsEC was a predecessor to the EAEU.
- In EurAsEC, trade diversion and transfers from Kazakhstan, the Kyrgyz Republic and Tajikistan to Russia induced members to apply the common external tariff on only about 50-60 percent of the tariff lines.
- They applied the CET on the low tariff items with low trade diversion.
- It became known as a customs union “a la carte.”
- The transfers to Russia without offsetting gains were the reason EurAsEC failed.
- Since the EAEU also applies the Russian tariff as the CET, this bodes badly for the ultimate success of the EAEU.

# Russia's WTO commitments will substantially reduce its tariffs and reduce the transfers

- The EAEU will lower the CET to accommodate Russia's WTO commitments.
- Russia's un-weighted (weighted) applied average MFN tariff and the CET of the EAEU will be reduced from 11.5 (13) percent in 2011 (prior to WTO commitments) to 7.9 (5.8) percent in 2020 (after all commitments are implemented). Shepotylo and Tarr, *Eastern European Economics*, 2013.
- Then the trade diversion and losses of Russia's partners will be substantially reduced.

Russia's WTO commitments will increase welfare of Belarus on a net basis, but Belarus will suffer preference erosion.

- For Belarus, estimates are the tariff reductions will increase their real income (welfare) by 1.1 percent of the value of their consumption.
- There are two impacts:
- (i) An increase in real income by 2.0 percent of consumption from a more efficient resource reallocation (gains from trade);
- (ii) a decrease in real income of 0.9 percent of consumption from preference erosion in Russian and partner markets for exports from Belarus.
- See Balistreri, Tarr and Olekseyuk in World Bank (forthcoming).



# Violation of WTO Bound Tariffs for the Kyrgyz Republic and Kazakhstan—can be solved

- Kazakhstan and the Kyrgyz Republic will have to violate their WTO commitments in order to implement the CET of the EAEU.
- If WTO members object, the EAEU will be obligated to “compensate” the WTO members, by reducing bound tariffs to provide comparable market access.
- Shepotylo and Tarr (2013) show that there is “water in the tariff” of the EAEU. See table 2
- That is, there are almost 1,500 tariff lines where the final bound tariff of Russia at the WTO is higher than the final applied MFN tariff.
- Thus, it is possible for the EAEU to “compensate” the WTO members without lowering applied MFN tariffs.

# Crucial to Provide Offsetting Benefits to Russia's Partners in the EAEU

- Although WTO accession reduces losses, Kazakhstan, Armenia and the Kyrgyz Republic will continue to suffer trade diversion losses.
- Some may argue that there are political benefits from closer trade that are adequate compensation.
- E.g. France and Germany are now at peace.
- But without mutual gains, a Customs Union can inflame tensions.
- E.g., The US civil war; East African Customs Union in the late 1970s; Central American Common Market in the late 1970s.
- The EU has historically avoided policies that create large transfers.

## **Reduction of Non-Tariff Barriers and Improved Trade Facilitation could make the agreement beneficial for countries suffering trade diversion.**

- Jensen and Tarr in World Bank (2012) estimate that in the “optimistic” scenario, where NTBs are effectively reduced and trade facilitation is improved, the agreement would overcome the trade diversion and be beneficial for Kazakhstan.
- Since 2010, the Customs Union has endeavored to make progress in these two crucial areas.
- What evidence is there of improvement?

# Non-Tariff Barriers—Serious Problems in the EAEU, possibly worsened by the EAEU

- Internationally and in the EAEU, Sanitary and Phyto-Sanitary (SPS) regulations and technical regulations on industrial goods (Technical Barriers to Trade, TBTs) are now the main mechanism countries use for NTBs—see Cadot and Gourdon, 2014.
- Econometric and descriptive evidence reveals these barriers remain a serious problem in the EAEU.

# NTBs remain a serious problem in the EAEU

- Econometric estimates of Tochitskaya for the Eurasian Development Bank (2015) are that the ad valorem equivalents of the barriers of exporters (as a percent of the value of their exports) are:
  - From Kazakhstan to Belarus—40%
  - From Belarus to Kazakhstan—16%
  - From Kazakhstan to Russia—14%
  - From Russia to Belarus—12%
  - From Russia to Kazakhstan—10%
  - From Belarus to Russia—6%

**Table 3: Estimates of the Ad Valorem Equivalents of Barriers faced by Exporters from Belarus, Kazakhstan and Russia in each others' markets**

Sector	Belarus		Kazakhstan		Russia	
	Kazakhstan	Russia	Belarus	Russia	Belarus	Kazakhstan
Agriculture, forestry and fishing	26.3	7.6	39.2	12.4	11.5	11.8
Manufacture of food products, beverages and tobacco	10 .2	8 .1	39 .7	15 .0	14 .8	9 .2
Textile and clothing manufacture	9 .7	2 .8	55 .1	5 .7	12 .9	5 .3
Manufacture of leather, leather products and footwear	24 .0	10 .3	72 .0	35 .0	20 .4	17 .9
Manufacture of wood and wood products	24 .2	3 .4	0 .0	14 .6	5 .9	13 .7
Pulp and paper production, publishing activities	20 .7	5 .5	0 .0	6 .8	13 .0	7 .9
Chemical production	8 .5	3 .4	76 .1	11 .3	20 .1	10 .7
Manufacturing of pharmaceutical products	14 .6	13 .9	0 .0	38 .4	14 .7	8 .2
Manufacture of rubber and plastic products	14 .7	7 .6	57 .3	15 .6	15 .9	13 .7
Manufacture of other non-metallic mineral products	12 .5	3 .6	62 .0	6 .8	11 .7	9 .9
Metallurgical production, manufacture of fabricated metal products	18 .1	5 .6	21 .6	6 .8	7 .1	8 .0
Manufacture of machinery and equipment	12 .0	5 .8	46 .4	9 .0	11 .8	8 .5
Manufacture of electrical and optical equipment	11 .7	5 .8	62 .7	13 .6	9 .0	9 .5
Manufacture of transport equipment	11 .2	3 .5	26 .1	6 .9	6 .1	10 .1
<b>Overall Average</b>	<b>16 .3</b>	<b>6 .3</b>	<b>39 .8</b>	<b>14 .0</b>	<b>12 .4</b>	<b>10 .4</b>

# Counter-Sanctions—induced a “trade war” between Russia and Belarus

- Russia imposed counter-sanctions on Western countries.
- Belarus and Kazakhstan refused to implement the sanctions.
- This is a breach in the common external trade policy of the EAEU and undercuts the authority of the Eurasian Economic Commission.
- Russia accuses firms in Belarus of importing products banned in Russia, and selling them in Russia (allegedly en route to Kazakhstan).
- Russian authorities have ruled that these products from Belarus are unsafe for human consumption—a fact Belarus disputes.
- Belarus, in response, has increased inspections on Russian trucks entering Belarus.

# Kazakhstan-Russia NTBs

- Kazakhstan banned meat products from Russia in March 2015, saying these products violated standards.
- Russia said Kazakhstani products did not meet the Kazakhstani required standards and imposed counter-barriers.
- In March 2015, Kazakhstan suspended fuel and gas imports from Russia to protect its market from “a surplus of Russian oil products.”



# Trade Facilitation—Some progress made

Customs Union eliminated internal customs posts and reduced costs of trading across borders within the Customs Union for that aspect.

Rules of origin do not appear to be enforced more strictly as a result of the Customs Union.

Time Series of Data from Doing Business--See Table 4.

Belarus shows substantial improvement in 2012, 2013 and 2014 in the cost of importing and exporting a container. In 2014, it falls to about 20%-25% of the 2011 cost.

Did the Customs Union have an impact on lowering trading costs with a two year delay?

**Table 4: Efficiency of Trading Across Borders by the EAEU Members**

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Measure	Year*	Armenia		Belarus		Kazakhstan		Kyrgyz Republic		Russia	
		export	import	export	import	export	import	export	import	export	import
<b>Time (days) to Export/Import</b>	2009	20	20	16	31	84	71	63	72	24	23
	2010	16	18	15	30	76	62	63	72	24	23
	2011	16	18	15	30	76	62	63	72	24	23
	2012	16	18	15	30	81	69	63	75	24	23
	2013	16	18	15	30	81	69	63	75	21	20
	2014	16	18	15	30	79	67	63	73	21	19
	2015	16	18	15	30	79	67	63	73	22	20
<b>Cost to export/import in US dollars per container, deflated</b>	2009	2721	3137	7437	8876	4919	5001	3000	5050	3196	3326
	2010	2556	2984	7034	8396	4699	4777	3010	4899	3706	3834
	2011	2577	2974	7716	9163	4094	4303	3210	4683	3179	3292
	2012	2471	2852	3045	4725	5212	5190	4160	5209	2963	3174
	2013	2503	2889	1742	2702	5185	5163	4360	5215	2461	2616
	2014	1885	2175	1460	2265	5285	5265	4760	6000	2401	2595
	2015	1885	1885	1460	2265	5285	5265	4760	6000	2705	2920
<b>Distance to Frontier (on trade)**</b>	2009	56.0		34.6		5.8		12.9		42.1	
	2010	64.0		35.2		11.5		13.9		38.8	
	2011	63.9		35.2		15.1		15.1		45.4	
	2012	64.7		46.1		8.1		12.6		46.6	
	2013	64.5		56.8		8.2		12.7		53.0	
	2014	68.8		59.1		7.9		9.7		50.5	
	2015	64.5		56.8		8.2		12.7		51	

\*Data for year t is taken from the Doing Business Survey from year (t+1).

\*\* A measure of the regulatory regime for trade compared to the best practioners in the world. The scale is 0 to 100, with higher scores being bett

**Source: World Bank Doing Business Survey**, various years.

# Trade Facilitation—Some progress made

- For Russia, significant improvement in export and import costs 2011-2014, but partial reversal and increase in costs in 2015.
- EAEC may explain the drop in costs, but also possible that WTO accession in 2012 or the World Bank-Government of Russia Customs Modernization project contributed.
- For Kazakhstan, initial improvement in 2011, the got worse than in 2010 in later 2012-2015.
- For Belarus, spectacular improvement 2012-2014. Very difficult to explain. From one of the most expensive countries to competitive.

# Trade Facilitation—Some negatives due to the EAEU—On balance, some gains

- But additional inspections are now required when goods must transit one member country destined for another.
- As a result, some Polish trucks avoid going through Belarus and take an indirect route to Russia through Lithuania and Latvia (and sometimes Estonia).
- The additional inspections third country goods are subject to is a violation of the WTO SPS agreement.
- Belarus increasing inspections on Russian goods in its trade war

# Bottom line for the 5 Countries

- **Belarus: Oil and Gas Subsidies Dominate**
- Its transfers to Russia from tariff changes were much smaller than from the other 3 countries (but were positive).
- Oil and gas subsidies dominate the bilateral relationship.
- Russia sharply reduced the subsidies in 2010, but subsidies remain.
- In general, Belarus defers to Russia on most trade matters in order to preserve the energy subsidies.

# Kyrgyz Republic: Migration Dominates

- A substantial negative for the Kyrgyz is that they will have to impose the CET on Chinese imports. Over 50% of their imports come from China.
- There is a substantial apparel processing industry in Dordoi, Kyrgyzstan dependent on Chinese inputs.
- But 31% of their GDP is from remittances from workers in Russia and Kazakhstan, who can travel to Russia without visas, but work there illegally. Membership in the EAEU promised work permits for its citizens.
- In addition, the Kyrgyz were promised \$1.2 in transition aid from Russia, and gas and electricity investments from Gazprom and Inter RAO.

# Armenia: Larger Economic Losses Dominated by Military Support

- Armenia also had to raise its tariffs significantly.
- More importantly, Armenia had to reject its Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, with loss of TFP from technology transfer.
- Armenia also very dependent on remittances from workers in Russia.
- Most important, is that Armenia needed Russia's security guarantee of the Nagorno-Karabakh region.

# Kazakhstan—hopes for a beneficial economic union, while avoiding broader integration.

- Almost equal per capita income as Russia
- Does not receive subsidies from Russia and remittances not very important.
- Kazakhstan still faces high NTBs and has not lowered the costs of trading across borders.
- Nazarbayev in 2013 complained that the Eurasian Union imposed more costs than benefits on Kazakhstan.
- But Nazarbayev remains committed to an Eurasian Union that he hopes will provide economic benefits.
- But he wants to avoid security, monetary and political integration, and especially avoid Russia's battle with the West.



# Russia--

## **What it gives:**

Subsidies, loans and politically motivated investments in various forms to the poorer states

Military support to Armenia

Right to work for countries dependent on remittances

## **What it receives:**

A tariff structure that favors Russian industry

Putin hopes to get a union that allows Russia to lead a block of countries that competes with the European Union for influence in Europe and maybe the world stage

Ukraine was crucial to Putin's vision—Ukraine shows Russia has the power to disrupt the plans of the European Union, but not to create a unified regional project of substantial magnitude

# Conclusions—crucial to implement further reforms to implement deep integration

- Schiff and Winters: real benefits of preferential trade agreements come from deep integration.
- Tariff structure leads to transfers to Russia, which diminish with WTO.
- But deep integration aspects of NTB reforms, trade facilitation, right to work legally for migrants, agricultural subsidy reduction regulations and services integration may provide benefits to all.
- Progress to date on the crucial NTB and trade facilitation issues is mixed.
- But it is still early in the life of the EAEU, the EU took decades to achieve the objectives of the EAEU.
- Russia will have to press for real reform in these areas, which will involve, in part, ceding real authority to the Eurasian Economic Commission.