

# Post-Communist Economic Integration : Belarus, Kazakhstan, and Russia

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## Abstract

The focus of this paper is the political economy of integration in the framework of the Customs Union and Single Economic Space. Clearly, Russia is a dominant power in this project, and her political interests may outweigh economic ones. However, neither Belarus nor Kazakhstan is forcefully pushed into the Customs Union and Single Economic Space. From the economic viewpoint, they join because Russia is the biggest and most accessible market for their exports, and is also rich in natural resources, which is particularly important for Belarus. There is likely to be both trade creation and trade diversion within the Customs Union and Single Economic Space, and it will concern mainly manufactures, which are now predominantly imported from the outside world. Increased demand for local manufactured goods, in turn, should lead to more employment opportunities in manufacture and agriculture sectors, and better social security for the workers of Belarus, Kazakhstan, and Russia. On the political side, though, this will inevitably play in the hands of the increasingly undemocratic political regimes.

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**Key words:** Economic Integration, Customs Union, Political Economy, Post-communism

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## I. Introduction

Ever since the breakup of the USSR in 1991, the issue of integration has loomed largely on the political agenda for some former Soviet republics, especially Russia. It is frequently treated with suspicion in the West as an attempt of 'recovery of the powerful' Soviet empire (Grinberg 2005, p. 156).<sup>1</sup> But in reality, the volume of trade within the Commonwealth of Independent State (CIS), the organization set up as a platform for cooperation among former Soviet republics, has fallen more than twice from 1992 to 2000, and was restored only by 2006. Similarly, out of 37 agreements signed by CIS members from 1991 to 2008, only 3 have been ratified by all member states; out of 290 documents subject to internal procedures, such procedures have been done only in one case (Miasnikovich 2011, p. 123).<sup>2</sup> In the aftermath of the global financial crisis, postcommunist integration has been reinvigorated, but it is still unclear how sustained this new impetus will prove to be.

To begin with, the ex-Soviet space appears ample with integration projects: Eurasian Economic Community (EurAsEC), Central Asia Regional Economic Cooperation Program (CAREC), CIS, Customs Union (CU), Organization for Democracy and Economic Development (GUAM), Single Economic Space (SES), Shanghai Cooperation Organization (SCO), Union State of Belarus and Russia. Some of them, like CIS, were launched in an attempt to preserve economic, social, and political links after the USSR breakup; others, like the CU, EurAsEC, and SES, aim at fostering foremost regional economic cooperation; while some, such as GUAM or SCO, carry more political weight than economics in their agenda. It is obvious that none of these projects proved to be particularly efficient and worth comparing with widely recognized examples of good integration practice such as the European Union (Simon 2010, p. 21~22).<sup>3</sup> Still, their very existence and evolution have undoubtedly contributed to relatively peaceful socio-economic development in the area, especially in the view of more tragic examples of communist disintegration such as the former Yugoslavia.

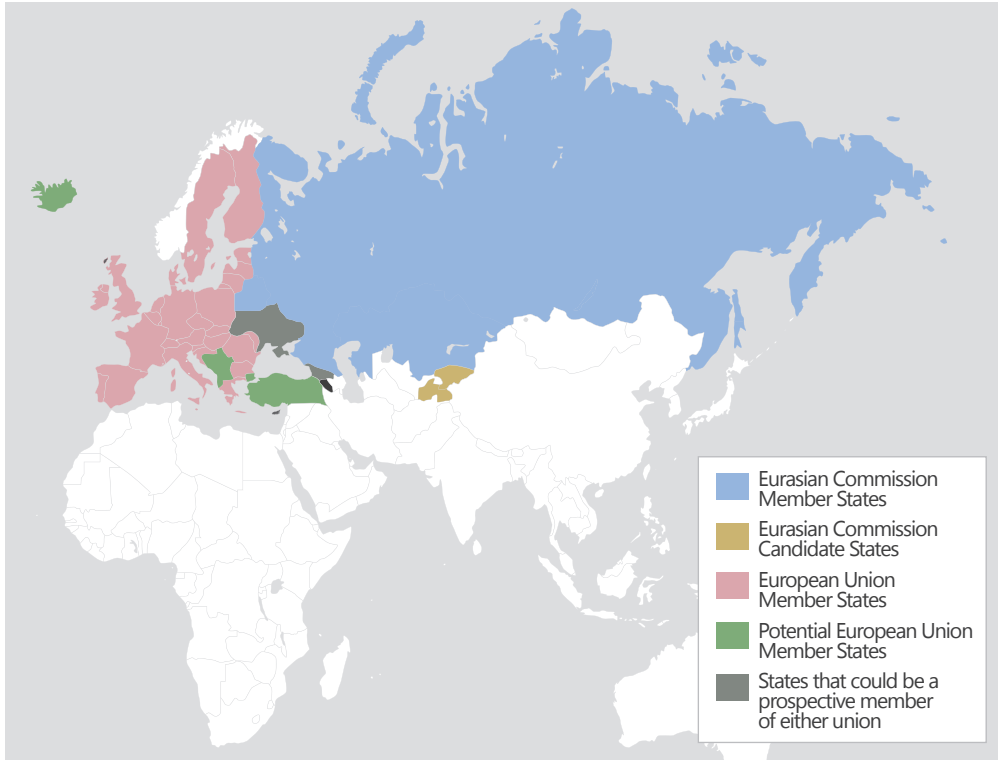
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<sup>1</sup> Grinberg, Ruslan, "Russia and international economic structures," in Graham, Edward, Nina Oding and Paul Welfens (eds.) *Internationalization and Economic Policy Reforms in Transition Countries*, Berlin/Heidelberg/New York: Springer, 2005.

<sup>2</sup> Miasnikovich, Mikhail, *Strukturalnaya Politika i Modernizatsiya Ekonomiki Respubliki Belarus (Structural Policy and Modernization of the Economy of the Republic of Belarus)*, Minsk: Belaruskaya Navuka, 2011.

<sup>3</sup> Simon, György, "On the Customs Union of Belarus, Kazakhstan and Russia," *Economic Annals*, LV, 184:7-28, January-March 2010.

**Figure 1. Map of the key integration projects in northern Eurasia**



(Note) Country codes are taken according to ISO 3166-1 standard.

(Source) Taylor 2013.

The focus of this paper is integration in the framework of the Customs Union and Single Economic Space (CU/SES), relatively new phenomena not yet properly reflected in the English-language academic literature. Here, we will seek to uncover the political economy of such integration by inquiring of its driving forces and major problems.

## II. Literature Review

### A. Historical background

From its name, one can assume that the CU/SES is foremost an economic project, aimed at facilitating trade among its partners and harmonizing trade policy towards third parties. The origins of the CU/SES project can be traced back to January 6, 1995, when Russia and Belarus signed the bilateral Customs Union Agreement (Shadikhodjaev 2009, p. 559).<sup>4</sup> In the same month, Kazakhstan joined, and a year later by Kyrgyzstan (Simon 2010, p. 11). In February 1999, shortly after the August 1998 Russian financial crisis, these countries, as well as Tajikistan, signed a new Treaty on Customs Union and Single Economic Space (Shadikhodjaev 2009, p. 559). Since 2000, the project continued in the framework of the The Eurasian Economic Community (EurasEC), with Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan as full members, and Armenia, Moldova, and Ukraine acted as observers whereas Uzbekistan joined in 2006, but its membership was suspended in 2008 (About 2011).<sup>5</sup> Despite having all the attributes of an international organization (Shadikhodjaev 2009, p. 560), it was argued that in practice the EurAsEC amounted to no more than a free trade area with substantial (around 60%) but not complete tariff unification and some anti-dumping procedures (Glinkina 2008, p. 6;<sup>6</sup> Simon 2010, p. 11). As a confirmation of EurAsEC's apparent failure to become the locus of postcommunist integration, the governments of Belarus, Kazakhstan, and Russia signed yet another agreement in 2009 to create a Customs Union, with this third attempt envisaged as a step to further integration in the form of the SES. As reported by IMF, this agreement came into force in January 2010, when the three countries eliminated most duties on mutual trade, and moved to harmonize customs rules; in July 2010, member countries adopted a common customs code, finalized customs rules, and began to redistribute collected duties (IMF 2011, p. 21).<sup>7</sup> Finally, the Single Economic Space is officially presented as a further stage in postcommunist integration, a kind of common market for goods, services, and labour, which would also involve high degree

<sup>4</sup> Shadikhodjaev, Sherzod, "Trade integration in the CIS region: a thorny path towards a customs union," *Journal of International Economic Law*, 12, 3:555-578, May 2009.

<sup>5</sup> "About EurAsEC," <http://www.evrases.com/en/about/>, November 7, 2011.

<sup>6</sup> Glinkina, Svetlana, "Russian ideas on integration within the CIS space: how do they match or clash with EU ideas," *Institute for World Economics Working Paper No. 182*, Budapest: Hungarian Academy of Sciences, October 2008.

<sup>7</sup> IMF Country Report 11/151, June 2011, <http://www.imf.org/external/pubs/ft/scr/2011/cr11151.pdf>.

of coordination with economic reforms. It has reportedly come into force in 2012.<sup>8</sup>

## B. Political background

It is sometimes believed that any integration in the former Soviet Union involving Russia is more about politics than economics, and is basically driven by desire to reinstall the Soviet borders. While this may be true to some extent, there is nothing unusual in the fact that Russia may want the CU/SES project for political reasons. Looking back in history, the German Zollverein, the pioneer and by far the most important customs union, was engineered by Prussia primarily for political reasons, in order to gain hegemony or at least influence over the smaller German states (Viner 1950, p. 97–98).<sup>9</sup> On the other hand, it would be unwarranted to ignore economic rationale behind postcommunist integration. To begin with, Soviet republics were very closely integrated within the former Soviet Union (Freinkman 2004, p. 23).<sup>10</sup> Soviet economy featured quite considerable extent of internal goods exchange due to centrally planned specialization among the republics and the Union's general closeness to the global economy (Simon 2010, p. 21). The USSR break-up led to substantial contraction of this exchange among the former Soviet republics, estimated at as much as 50% for the period between 1992 and 1995 (Michalopoulos 1997, p. 1).<sup>11</sup> It seemed natural, then, that new independent states sought some sort of solution to this problem, which many of them found in a variety of policy interventions, including Free Trade Agreements and Customs Union (*Ibid*).

Russia's lead in the regional postcommunist integration is understandable not only for its apparent political reasons. Being the single most dominant trading partner for the majority of the CIS countries both in terms of exports and imports (Freinkman 2004, p. 11), while excluded from the EU, the largest regional economic organization, and until August 2012 excluded also from the WTO, the largest international trade body, Russia naturally sought to coordinate trade on the territory of the former USSR. It is also

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<sup>8</sup> "Edinoe ekonomicheskoe prostranstvo nachalo deistvovat 1 yanvarya" (Single Economic Space began functioning since January 1), [http://naviny.by/rubrics/economic/2012/01/01/ic\\_news\\_113\\_383898/](http://naviny.by/rubrics/economic/2012/01/01/ic_news_113_383898/), September 24, 2013.

<sup>9</sup> Viner, Jacob, *The Customs Union Issue*, New York: Carnegie Endowment for International Peace, 1950.

<sup>10</sup> Freinkman, Lev, Evgeny Polyakov and Carolina Revenco, "Trade Performance and Regional Integration of the CIS Countries," *World Bank Working Paper No. 38*, Washington, D.C.: World Bank, 2004.

<sup>11</sup> Michalopoulos, Constantine and David Tarr, "The economics of customs unions in the Commonwealth of Independent States," *Policy Research Working Paper No. 1786*, Washington, D.C.: World Bank, 1997.

important to remember that from the very start of postcommunist transformation, most former Soviet states, including Russia, were restrained in their access to Western markets by significant tariff and nontariff barriers (Michalopoulos 1993, p. 19).<sup>12</sup> According to World Bank investigations, due to OECD tariff preferences for developing countries, exports from the former USSR had significant competitive disadvantages even despite relatively low average tariffs of 5 to 7% (*Ibid*). In addition, there were important nontariff impediments, especially prevalent for food products, leather, textiles, and ferrous metals. For example, Ukraine faced nontariff barriers or significant tariff discrimination for 44% of its manufactures exports to OECD markets (Michalopoulos 1993, p. 20). Taking into account a very high concentration of exports in most CIS countries, whereby their top ten export items at the three digit-SITC level accounted for more than three-quarters of their exports (*Ibid*), these restrictions might have had quite a severe effect on the fragile postcommunist economies. In this respect, the CU/SES project may be seen as a retaliation to the initial Western trade constraints, whereby Russia could pursue more protectionist policies in the name of some collective interest without being accused of undermining postcommunist liberalization.

### C. Theory of customs unions

In theory, customs unions are supposed to shield countries at comparable level of economic development from stronger foreign competitors while promoting mutual trade among the members. There can be both trade creation and trade diversion in the customs unions (Viner 1950, p. 44), but in general they are aimed at increasing internal trade at the expense of external trade (Balassa 1961, p. 24).<sup>13</sup> Thus, customs unions may be unfavorable for international trade, especially for its champions, as they may limit their access to foreign markets and make it more difficult to negotiate trade preferences individually. As argued by Simon, the theory of customs unions was originally elaborated by List (1991), who represented a point of view different from that of Smith and Ricardo (Simon 2010, p. 10). According to the latter, free trade could benefit all countries regardless of their development level, while List emphasized the importance of industrial development level and contended that in practice, free trade favored only

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<sup>12</sup> Michalopoulos, Constantine, "Trade issues in the New Independent States," *Studies of Economies in Transformation*, 7, Washington, D.C.: The World Bank, 1993.

<sup>13</sup> Balassa, Bela, *The Theory of Economic Integration*, Homewood: Richard D. Irwin, 1961.

advanced industrialized countries (List 1991).<sup>14</sup> Recognizing the development trap of isolationism, though, he proposed a third way, whereby countries at the similar level of development would unite in a customs union, completely liberalizing their internal trade, but sifting the borders for external trade, thus making them relatively rather than absolutely open to the world (List 1991, p. 188).

In the postwar period, the theory of customs unions was revived by the works of Giersch,<sup>15</sup> Meade,<sup>16</sup> Viner, as well as Balassa. These authors provided a consistent theoretical analysis of a customs union, notably its impact on trade flows (Viner 1950), production (Meade 1955), location of economic activity (Giersch 1949), and welfare (Balassa 1961). Arguably, this interest was sparked by the process of European integration, where the Customs Union was formed in 1968 (About 2009).<sup>17</sup> Basically, it is the European integration experience, including its Customs Union, which might have guided the process of economic integration in the former USSR (Miasnikovich 2011, p. 114, 130).

### III. The Political Economy of Integration

#### A. Common factors

The general driving forces of postcommunist integration in the framework of CU/SES can thus be found both in the political and economic spheres. Indeed, Russia is a dominant power in the process, and its political interests here may outweigh economic ones, but it is noteworthy that neither Belarus nor Kazakhstan is forcefully pushed into CU/SES. They seem to do it voluntarily by realizing that Russia is the biggest and most accessible market for their exports, especially for Belarus, Russia is a source of cheaper natural resource imports. Thus, postcommunist integration in the case of CU/SES has not lacked economic rationale. That does not mean, however, that it is based on a rock

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<sup>14</sup> List, Friedrich, *The National System of Political Economy*, Fairfield: Augustus M. Kelley, 1991.

<sup>15</sup> Giersch, Herbert, "Economic union between nations and the location of industries," *Review of Economic Studies*, 17, 2:87-97, 1949.

<sup>16</sup> Meade, James, *The Theory of Customs Unions*, Amsterdam: North Holland Publishing Co., 1955.

<sup>17</sup> "About the Customs Union," [http://ec.europa.eu/taxation\\_customs/40customs/customs\\_general\\_info/about/index\\_en.htm](http://ec.europa.eu/taxation_customs/40customs/customs_general_info/about/index_en.htm), January 1, 2009.

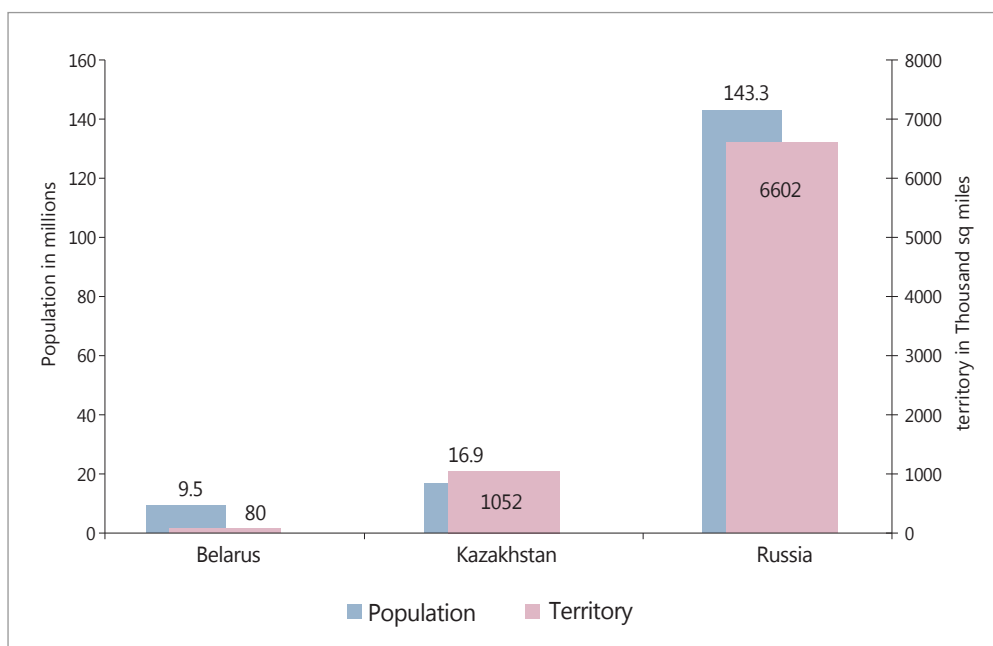
solid foundation and has no significant problems. By looking at Belarus, Kazakhstan, and Russia, it is obvious that their integration may be complicated by the following:

- i) the three integrating partners are very different in terms of size;
- ii) their mutual trade is quite limited;
- iii) they pursue different economic models.

Take the issue of size, for example. Belarus's territory is only one thirteenth of Kazakhstan and one eightieth of Russia. In fact, Russia is the largest country not only in the former USSR, but in the world, while Kazakhstan ranks 9<sup>th</sup>, and Belarus only 86<sup>th</sup>. Similar discrepancy is observed in population where Belarus has slightly less than 10 million people, Kazakhstan just over 16 million, and Russia have 143 million, ranking 87<sup>th</sup>, 62<sup>nd</sup> and 8<sup>th</sup> in the world, respectively (see Figure 2).

**Figure 2. Population and territory**

(2013)



(Source) Author's calculation, using data available from CIS Statistics.<sup>18</sup>

<sup>18</sup> Database "Statistics of the CIS", <http://www.cisstat.com/2base/frame01.htm>, March 21, 2014.



It is logical to expect that customs unions and common economic areas are formed by countries which already have a lot of common trade. This is not the case with the CU/SES, though. Since 2008, the degree of intra-CU trade stood at mere 12%, showing a declining trend since 1995 (Simon 2010, p. 22). Furthermore, Russia’s trade within the CU was even less significant, at less than 8 per cent for both exports and imports in 2013. The case of Kazakhstan seems more controversial, as in 2013 the CU accounted for only 7.1% of her exports, but as much as 37.6% of her imports.<sup>19</sup> In fact, with nearly half of its foreign trade taking place with Kazakhstan and Russia, only Belarus exhibited strong dependence on mutual trade within the CU shown in Table 1.

**Table 1. Share of mutual trade in total foreign trade turnover**

(Unit of measure, %)

	2009	2010	2011	2012	2013
<i>Customs Union</i>	12.4	11.3	12.5	12.7	10.9
<i>Belarus</i>	48.1	48.6	45.7	48.4	50.7
<i>Kazakhstan</i>	18.0	17.6	21.0	18.0	18.4
<i>Russia</i>	7.7	6.9	7.7	8.0	7.5

(Source) Author’s calculation, using data available from the Eurasian Economic Commission.

Finally, as far as economic models are concerned, Belarus again stands out *vis-à-vis* its partners. While both Kazakhstan and Russia have chosen what seems to be neoliberal models of postcommunist development, Belarus rejected neoliberalism in favor of its own socially-oriented market economy model (NBRB 2001, p. 9~10).<sup>20</sup> Following the classification proposed by a well-known Russian economist Grigoryev, Belarus appears to be the only country in the former Soviet Union that pursued an industrial model of socio-economic development. It has avoided a migratory model, i.e. dependent on remittances from emigrant workers, typical for Armenia, Georgia, Kyrgyzstan, Moldova,

<sup>19</sup> “Ob itogakh vzaimnoi torgovli tovarami gosudarstv-chlenov Tamozhennogo soyuza i Edinogo ekonomicheskogo prostranstva za 2013 god” (On results of mutual trade in goods among member-states of the Customs Union and the Single Economic Space in 2013), [http://www.eurasiancommission.org/ru/act/integr\\_i\\_makroec/dep\\_stat/trade/Documents/Analytics\\_I\\_201312.pdf](http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/trade/Documents/Analytics_I_201312.pdf), April 2, 2014.

<sup>20</sup> NBRB (National Bank of the Republic of Belarus) *Ekonomika i bankovskaya sistema: obzor-2000 (Economy and banking system: overview 2000)* Minsk: NBRB, 2001.

Tajikistan, and Uzbekistan. Likewise, it lacked natural resources for a resource-based model of Azerbaijan, Kazakhstan, Russia, and Turkmenistan, and did not choose a service-based model of the Baltic states (Grigoryev 2007, p. 24~26;<sup>21</sup> Simon 2010, p. 17).

All of the above considerations make the political economy of integration in the framework of CU/SES project quite complicated. Following the argument by Simon (2010), resource-orientation of bigger CU/SES economies deprives them of interdependence and inter-complementary character, thus making the whole integration project less efficient and hardly sustainable. For industrially-active but relatively small Belarus, it would be hard to harness the CU/SES economic policies at internal industrially-based development. Indeed, the seemingly chaotic history of the CU/SES integration can serve as the best confirmation to this argument. One should also take into consideration that the CU/SES project is undertaken by countries with rather illiberal political systems. As such, it may be viewed as an elite project lacking democratic legitimacy. Indeed, the issue of integration has never featured high in political deliberations in any of the three partner countries, with similarly little attention from the media. Some would say this is so because people in all three countries take mutual integration for granted, and there is actually little to discuss. Besides, in Belarus, people overwhelmingly voted for integration at a referendum in 1995 (Belarusian 2011),<sup>22</sup> and while there were no similar referenda in either Russia or Kazakhstan, no one would arguably doubt the support of their people for integration. Perhaps being true for the early 1990s, this argument cannot be taken for granted now when more than twenty years have passed after the break-up of the USSR. A new generation of voters has matured in the postcommunist era that can be more skeptical about the virtues of single economic space, not to mention political. Nevertheless, the public debate on the CU/SES is virtually absent in Belarus, Kazakhstan, and Russia, which can be attributed both to their insufficiently liberal political systems and underdeveloped civil society.

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<sup>21</sup> Grigoryev, Leonid and Marsel' Salikhov, *GUAM – Pyatnadtsat' Let Spustya: Sdvigi v Ekonomike Azerbaidjana, Gruzii, Moldavii i Ukrainy, 1991-2006 (GUAM after Fifteen Years: Shifts in Economies of Azerbaijan, Georgia, Moldova and Ukraine, 1991-2006)*, Moscow: REGNUM, 2007.

<sup>22</sup> "Belarusian referendum, 1995," [http://en.wikipedia.org/wiki/Belarusian\\_referendum,\\_1995](http://en.wikipedia.org/wiki/Belarusian_referendum,_1995), August 28, 2013.

## B. Belarus' standing

Having established considerable differences among the integrating parties in the CU/SES project, it is logical to assume that besides some common factors, Belarus, Kazakhstan, and Russia may be driven by different forces, which require more specific consideration. In what follows, these countries will be analyzed in more detail with regard to their specific economic interests in the CU/SES. It will be demonstrated that despite differences in size, population and economic structure, these countries are seeking basically the same political economy effects from the integration. The analysis will start from Belarus as the smallest but remarkably active country in the CU/SES project.

It was on the territory of Belarus, in the Belavezhskaya Pushcha national park, that Soviet Union was formally written off from existence in December 1991. Hence, one would not expect much of enthusiasm about postcommunist integration from this relatively small European country of 9.5 million people, bordering the EU, Russia and, Ukraine in nearly equal proportions. Indeed, in the first years of its independence, Belarus seemed quite ambivalent about restoring political and economic ties with Russia and other former soviet peers, despite some efforts made by the country's first prime-minister V. Kebich, particularly with regard to monetary policy in 1993.<sup>23</sup> All that changed with the election of A. Lukashenka as the first president of the country in 1994. Almost immediately, he began seeking closer links with Russia, first signing the Customs Union treaty in January 1995, then the Community treaty in April 1996, and finally the Union State treaty in April 1997 (Miasnikovich 2011, p. 126). Thus, Belarus became the first former Soviet republic to reestablish close relations with Russia in both economic and political spheres, which apparently reflected preferences of the electorate, 78.6% of whom supported such an integration at the referendum of 1995 (Belarusian 2013).

The smallest country in the CU/SES project, Belarus has the most open economy in CIS (Freinkman 2004, p. 30), which features relatively advanced manufacturing and agriculture, as well as infrastructure and social sphere. The country's GDP has grown continuously from 1996 at an average rate of nearly 7%, and this growth has occurred while achieving nearly full employment. In fact, in 2009 Belarus was one of two

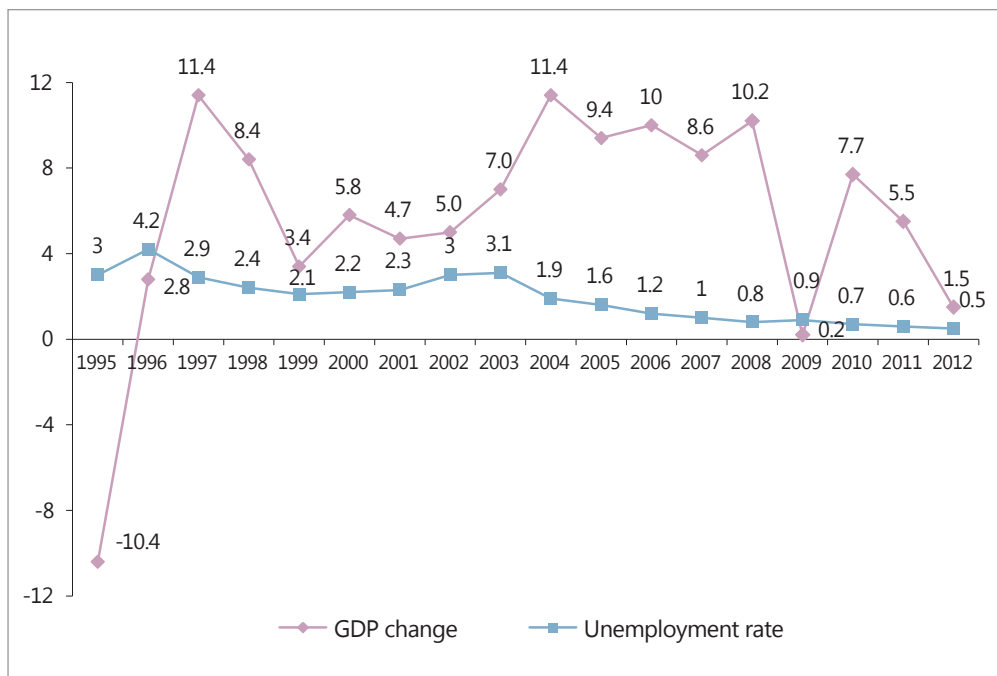
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<sup>23</sup> According to some sources, at the end of 1993 V. Kebich agreed with the then Russian prime-minister V. Chernomyrdin on the monetary union, which was never implemented though (Furman, Dmitryi (ed.), *Belorussiya i Rossiya: obshchestva i gosudarstva (Belarus and Russia: societies and states)*, Moscow: Prava Cheloveka, 1998).

countries in Europe, other being Poland, to avoid output contraction, and even in 2011, which was marked by severe domestic macroeconomic instability, it managed to register relatively high GDP growth and virtually no lay-offs as shown in Figure 3.

**Figure 3. GDP Growth and unemployment in Belarus**

(Unit of measure, %)



(Source) Author's calculation, using data from Belstat.

Lacking natural resources, Belarus has relied on its manufacturing, inherited from the Soviet period and preserved by the government policies, to provide reasonable levels of welfare for its citizens, evident in relatively low poverty and high wages and pensions as shown in Table 2.

**Table 2. Wages, pensions, and poverty**

	1995	2000	2005	2010	2011	2012
Wages, US dollar						
<i>Belarus</i>	66	89	215	407	411	441
<i>Kazakhstan</i>	79	101	256	527	614	682
<i>Russia</i>	104	79	303	682	796	863
Pensions, US dollar						
<i>Belarus</i>	34	46	98	195	152	175
<i>Kazakhstan</i>	31	28	77	153	187	200
<i>Russia</i>	53	29	90	248	279	291
Poverty, % living below minimum national income						
<i>Belarus</i>	38.4	41.9	12.7	5.2	7.3	6.3
<i>Kazakhstan</i>	34.6 <sup>a</sup>	31.8	31.6	6.5	5.5	3.8
<i>Russia</i>	24.8	29.0	17.7	12.8	12.7	11.0

(Note) a – data for 1996.

(Source) Author’s calculation, using data available from Belstat, Rosstat, Kazstat, and CIS Stat.

The openness of Belarus’ economy is evident from the trade statistics – the proportion of foreign trade has consistently been higher than GDP since the mid 1990s. The country’s trade is characterized by exports of manufactures and imports of natural resources. According to a special World Bank study on CIS trade performance, Belarus has been the only exception for the general withering of manufactured trade in the region (Frankstein 2004, p. 9). Indeed in the mid 1990s, manufactures comprised nearly four fifths of total export, or as high as Belgium at present, and even after substantial reduction in the last decade, they represented more than half of exports in 2010, or as much as Canada shown in Table 3.

**Table 3. Foreign trade of Belarus**

	<b>1995</b>	<b>2000</b>	<b>2005</b>	<b>2010</b>
Foreign trade (billion US dollar)	10.3	16.0	32.7	60.1
% GDP	100.0	153.4	107.7	110.4
<b>Exports (billion USD)</b>	<b>4.8</b>	<b>7.3</b>	<b>16.0</b>	<b>25.2</b>
Kazakhstan, % of total	1.6	0.3	1.1	1.8
Russia, % of total	60.5 <sup>a</sup>	50.7	35.8	38.5
EU, % of total	-	28.4	31.8	30.1
China, % of total	0.6	1.9	2.7	1.9
Mineral fuels (SITC 3), % of total	7.8 <sup>b</sup>	19.8	34.8	28.1
Chemicals, manufactures and machinery (SITC 5,6,7,8), % of total	78.2 <sup>b</sup>	65.3	52.0	53.2
Machinery and transport equipment (SITC 7), % of total	28.4 <sup>b</sup>	23.9	18.7	17.2
<b>Imports (billion US dollar)</b>	<b>5.5<sup>b</sup></b>	<b>8.7</b>	<b>16.7</b>	<b>34.9</b>
Kazakhstan, % of total	1.0	0.5	0.2	1.2
Russia, % of total	61.4 <sup>1</sup>	64.2	60.4	51.3
EU, % of total	-	21.4	19.6	-
China, % of total	0.2	0.5	1.7	4.7
Chemicals, manufactures and machinery (SITC 5,6,7,8), % of total	59.4 <sup>b</sup>	49.6	47.7	48.9
Chemicals, manufactures and machinery (SITC 5,6,7,8), % of total exports in Belgium	-	-	-	77.2
Canada	-	-	-	52.7

(Notes) a – data for 1996, b – data for 1998.

(Source) Author's calculation, using data available from Belstat, UN Comtrade and EBRD 2011.<sup>24</sup>

It should be noted that substantial increase of mineral fuels' share in total exports, typically criticized as a sign of Belarusian economic weakness and dependence on

<sup>24</sup> COMTRADE, United Nations Commodity Trade Statistics Database, <http://comtrade.un.org/db/>, November 24, 2011; EBRD (European Bank for Reconstruction and Development), "Economic data," <http://www.ebrd.com/pages/research/economics/data/>, November 29, 2011.

Russian subsidies (IMF 2011, p. 3;<sup>25</sup> Sievert 2011, p. 100)<sup>26</sup>, can also be interpreted as a confirmation of the country's strong refinery potential, as 95% of exports in SITC3 group are classified as petroleum products (SITC 334) rather than crude oil, as is the case in Kazakhstan and Russia. Having two large refineries on Russia's main oil pipelines to the West, with a total capacity of nearly half a million barrels a day, or as high as that of Sweden, it seems natural that Belarus captured for refining some of the Russian crude on its way to Europe, as Russian refining capacity has lagged far behind its production and reserve levels (BP 2013, p. 16).<sup>27</sup>

Russia's economic importance for Belarus goes without saying, but it is in no way limited to allegedly subsidized, but in fact commercial and mutually profitable supplies of oil, gas, and other raw materials. Russia is the major market for the bulk of Belarusian manufactures, being the largest consumer of Belarus-made tractors, trucks, combines, refrigerators, TV-sets, furniture and foodstuffs, particularly dairy products. Hence it is vital for Belarus not just for crude oil imports to make hard currency from selling petroleum products on the Western markets, but also for export-oriented industrial employment in the country. Indeed, exports to the EU provide jobs for less than one sixth employed in industry and less than 1 per cent of total employment, basically being important only for two cities in the country – Navapolatsk in the northeast and Mazyr in the southeast, with a compound population of 215 thousand people, or about 2% of the country's total population (Statistical 2012).<sup>28</sup> On the other hand, exports to Russia are concentrated in manufacturing industries, particularly machinery and transport equipment, which keep busy more than half of all industrial workers, or more than 10 per cent of total employment, with the capital Minsk being the largest export-oriented industrial hub. Carrying more added value and providing work for domestic R&D, these exports have been politically sensitive and important for Belarus, as yet in the Soviet times the country specialized in high-end manufacturing and its upkeep through the turmoil of postcommunist transformation has been a special pride for the incumbent authorities (Ioffe 2004, p. 90).<sup>29</sup> Besides, Belarusian manufactures are in most cases designed specifically for Russian consumers, and reorienting them to other markets

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<sup>25</sup> IMF Country Report No. 11/66, March 2011, <http://www.imf.org/external/pubs/ft/scr/2011/cr1166.pdf>.

<sup>26</sup> Sievert, Stephan, Sergey Zakharov and Reiner Klingholz, *The Waning World Power: The Demographic Future of Russia and the Other Soviet Successor States*, Berlin: Berlin Institute for Population and Development, 2011.

<sup>27</sup> BP (2013) *BP Statistical Review of World Energy June 2013*, from [http://www.bp.com/content/dam/bp/pdf/statistical-review/statistical\\_review\\_of\\_world\\_energy\\_2013.pdf](http://www.bp.com/content/dam/bp/pdf/statistical-review/statistical_review_of_world_energy_2013.pdf), 30.08.2013.

<sup>28</sup> *Statistical Yearbook 2012*, Minsk: National Statistical Committee of the Republic of Belarus, 2012.

<sup>29</sup> Ioffe, Grigory, "Understanding Belarus: Economy and Political Landscape," *Europe-Asia Studies*, 56. 1:85-118, January 2004.

would require substantial and costly technological and marketing advances, with no guarantees for eventual success in the view of fierce global competition in these market segments both from well established Western and Asian companies.

The Russian market, however, is getting more competitive itself, particularly in machinery and transport segments preferred by the Belarusian exporters, so integration in the framework of the CU/SES can also be seen as an attempt by Belarus to ensure more favorable terms of trade and maintain at least price competitiveness. There may also be strategic considerations – if both Russia and Kazakhstan get serious about modernization of their economies, which will inevitably include industrialization, particularly in Kazakhstan, Belarusian producers with their free market access and great deal of experience, could gain significant benefits, either through increased exports of equipment, or through closer industrial cooperation. On the other hand, relying on the Russian market may weaken the incentives to improve product quality and range, thus reducing competitiveness of Belarusian exporters in the long run. It also makes their radical restructuring unnecessary, as well as adopting more market-based macroeconomic policies for the whole economy. As such, being politically convenient for the incumbent Belarusian authorities, the orientation on the traditional Russian and other CIS markets may be strategically disadvantageous for the country. Unless, of course, both the Single Economic Space and WTO membership will succeed in promoting competition and prudent macroeconomics in all three integrating economies.

### C. Kazakhstan's standing

The second largest country in the CU/SES project in geographic, demographic and economic terms, Kazakhstan has long been claiming to be the leader of the postcommunist integration (Evraziyskaya 2010).<sup>30</sup> In his response to V. Putin's and A. Lukashenka's articles on integration in the Russian *Izvestia* newspaper, published several years ago, the country's president Nazarbayev (2011) highlighted his personal role in creating the CIS and EurAsEC, and offered to make Astana the capital of the CU/SES and of the future Eurasian Union.<sup>31</sup> Born at the onset of World War II in 1940, the Kazakhstani president obviously has the greatest political experience among

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<sup>30</sup> *Evraziyskaya Doktrina Nursultana Nazarbayeva (Nursultan Nazarbayev's Eurasian Doctrine)*, Almaty: 2010.

<sup>31</sup> Nazarbayev, Nursultan "Evraziiskiy soyuz: ot idei k istorii budushchego" (Eurasian union: from idea to the history of the future), *Izvestia*, <http://www.izvestia.ru/news/504908>, October 25, 2011.



his counterparts from Belarus and Russia to make such claims and offers. Indeed, despite quite intolerant attitude to political opposition and no leadership change since gaining independence in 1991, this country of 16.9 million people in Central Asia has been treated very differently by the West than a far smaller Belarus, located in the geographical center of Europe – one can recall, for example, Kazakhstan’s chairmanship of OSCE in 2010. Such an attitude can to a certain extent be explained by Kazakhstan’s rich endowment with natural resources, and above all – with oil and gas.

According to some official sources, Kazakhstan is one of the few states on the planet to be provided with substantial deposits of minerals and raw materials, with 99 chemical elements and 1,225 kinds of minerals found in its nearly 500 known fields (Mineral 2011).<sup>32</sup> Notably, it is claimed to have the second largest chromium, lead, uranium and zinc deposits, the third largest manganese reserves, the fifth largest copper reserves, the eighth – for iron ore, and ranks in the top ten for coal and gold (Mineral 2011; Kazakhstan 2005, p. 147).<sup>33</sup> Most significant, however, appears the country’s endowment with oil – with 30 billion barrels of reserves, or 1.8% of global total, and daily production of 1,728 barrels, or 2% of global total, Kazakhstan ranks 16<sup>th</sup> largest oil producer in the world (BP 2013, p. 6, 8).<sup>34</sup> Similarly strong is the country’s position on another key hydrocarbon – natural gas. According to the same BP statistics, Kazakhstan has 45.7 trillion cubic feet of proved natural gas reserves, or 0.7% of global total, and in 2012 produced 19.7 billion cubic feet of gas, or 0.6% of global total (BP 2013, p. 20, 22). It is oil, however, which seems to play a key role in the economy of Kazakhstan:

Oil sector value added accounted for 11½% of GDP in 2010, while oil exports represented nearly 57% of total exports of goods and services. The bulk of Foreign Direct Investment (FDI) in recent years has flowed to the extractive industries sector (75¼% in 2010), with oil taking the largest share. Crucially, the government depends on oil for the largest part of its revenues—in 2010, about 46½ % came from extraction and exports of oil’ (IMF 2011, p. 27).

Thus, Kazakhstan has a clearly resource-oriented economy, with manufacturing

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<sup>32</sup> “Mineral wealth,” Embassy of Kazakhstan to the US and Canada, <http://prosites-kazakhembus.homestead.com/mineralwealth.html>, November 8, 2011.

<sup>33</sup> *Kazakhstan Segodnya [Kazakhstan Today]*, Almaty: Agency of the Republic of Kazakhstan on Statistics, 2005.

<sup>34</sup> BP (2013) *BP Statistical Review of World Energy June 2013*, from [http://www.bp.com/content/dam/bp/pdf/statistical-review/statistical\\_review\\_of\\_world\\_energy\\_2013.pdf](http://www.bp.com/content/dam/bp/pdf/statistical-review/statistical_review_of_world_energy_2013.pdf), 30.08.2013.

accounting for a relatively small portion of the country's domestic product, employment, and exports. According to the IMF (2013, p. 18), the share of mining in GDP grew from 8% in 1998 to 20% in 2010, while the contribution of manufacturing and agriculture declined from 18 and 9% in 1998 to 12 and 6% in 2010, respectively. The country is also the least urbanized among its three CU/SES partners, meaning that agriculture plays an important role in employment shown in Table 4.

**Table 4. Structure of Kazakhstan's economy**

	1995	2000	2005	2010	2011	2012
GDP (nominal) (billion US dollar)	16.6	18.3	57.1	139.9	188.0	203.5
<i>Agriculture, % of GDP</i>	12.3	8.1	6.3	4.5	5.0	4.3
<i>Manufacturing, % of GDP</i>	-	-	-	11.3	11.4	11.3
Employment (million people)	6.6	6.2	7.3	8.1	8.3	8.5
<i>Agriculture, % of total</i>	21.8	31.3	33.2	28.3	26.5	25.5
<i>Manufacturing, % of total</i>	-	-	-	7.0	6.5	6.4

(Sources) IMF 2011; Kazakhstan 2013<sup>35</sup>

Foreign trade reflects the country's economic profile where exports have been dominated by oil, gas and mining products, while imports have mainly consisted of machinery and foodstuffs (Republic 2011, p. 16). Geographically, more than half of total merchandise exports go to EU and China, while the greatest share in imports is taken by EU, followed by Russia and China. Whereas for Belarus, trade within CU/SES is important both for export and import operations, Kazakhstan's trade here is concentrated in food and machinery imports from Russia, while trade with Belarus has been relatively insignificant as shown in Table 5.

<sup>35</sup> "Kazakhstan in figures," The Agency of Statistics of the Republic of Kazakhstan, <http://www.eng.stat.kz/digital/Pages/default.aspx>, November 23, 2011.

**Table 5. Foreign trade of Kazakhstan**

	<b>1995</b>	<b>2000</b>	<b>2005</b>	<b>2010</b>
Foreign trade (billion US dollar)	<b>9.0</b>	<b>13.6</b>	<b>45.1</b>	<b>81.2</b>
Exports (billion US dollar)	<b>5.2</b>	<b>8.7</b>	<b>27.8</b>	<b>57.2</b>
Belarus (% of total)	1.0	0.2	0.1	0.1
China (% of total)	5.4	7.7	8.7	17.7
EU (% of total)	-	40.6	45.8	34.4
Russia (% of total)	45.2	19.8	10.5	5.3
Mineral fuels (SITC 3) (% of total)	25.0	52.8	70.1	71.7
Chemicals, manufactured goods and machinery (SITC 5,6,7) (% of total)	56.6	30.3	19.8	18.0
Machinery and transport equipment (SITC 7) (% of total)	6.0	2.2	1.2	0.6
Imports (billion US dollar)	<b>3.8</b>	<b>4.9</b>	<b>17.3</b>	<b>24.0</b>
Belarus (% of total)	2.0	0.8	1.2	1.0
China (% of total)	0.9	3.1	7.2	16.5
EU (% of total)	-	26.6	25.6	28.8
Russia (% of total)	49.9	47.5	38.0	22.8
Chemicals, manufactured goods and machinery (SITC 5,6,7) (% of total)	53.4	68.7	72.4	70.5

(Source) UN Comtrade.

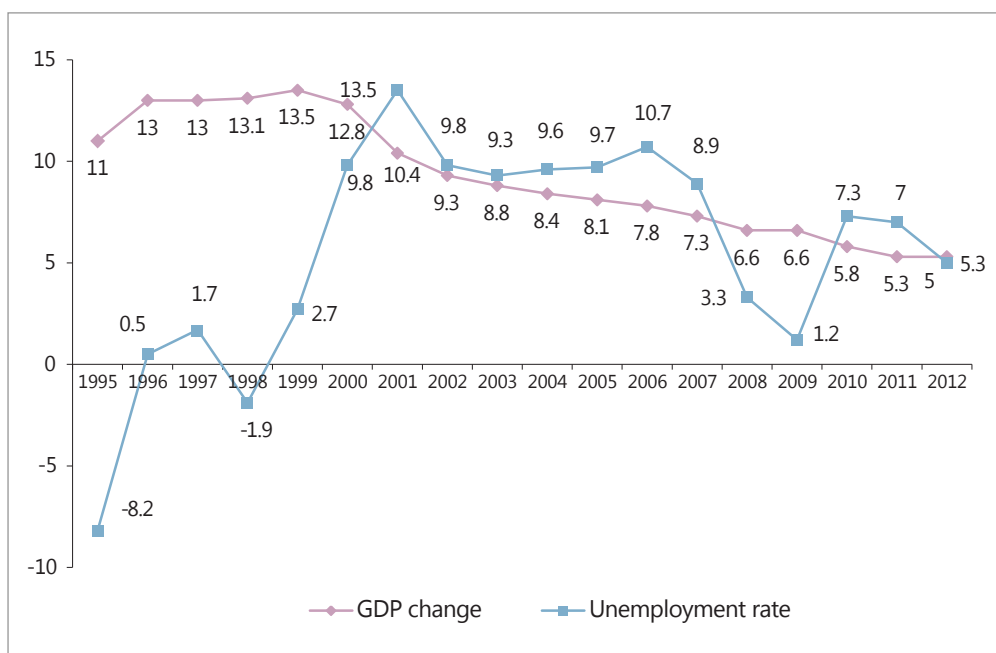
It should be noted, however, that due to its geographical location, Kazakhstan appears to have some advantages in commercial intercourse with China, the world's second largest and one of the most dynamic economies. Kazakhstan opted for a more protectionist trade regime within the CU/SES. Whether this was done for fiscal reasons, or with a view of shielding planned industrialization from international competition, notably from China, is not exactly clear, integration in the CU/SES is likely to carry both rewards and risks for Kazakhstan.

Overall, the virtue of the CU/SES project for Kazakhstan seems to lie in the opportunity to reduce its dependence on the oil sector, which is hampering both

industrialization and the effectiveness of macroeconomic policies by exposing them to oil price volatility (IMF 2011, p. 30~31). According to the IMF, Kazakhstan would gain from the greater access to the large Russian market and the eventual free movement of labor and capital, with agriculture and commodity exports set to benefit the most (IMF 2011, p. 21). Taking into account the country’s present economic structure and its industrialization plans for the future, its political economy rationale in pursuit of postcommunist integration appears similar to that of Belarus. Notably, the Kazakhstani authorities may be increasingly aware that their country’s socio-economic stability is highly dependent on employment opportunities available to ordinary Kazakhstanis, and the oil sector is not likely to provide them because it is more capital than labor intensive (IMF 2011, p. 30). Indeed, despite the 9-fold increase in both GDP and foreign trade since the mid 1990s, Kazakhstan has persistently had rather high unemployment, which has been only slowly absorbed by the expanding economy, shown in Figure 3.

**Figure 4. Unemployment and GDP growth in Kazakhstan**

(Unit of measure, %)



(Source) Author’s calculation, using data available from Kazstat 2013.

With half of the population still living in rural areas, the Kazakhstani authorities must be concerned about providing them with market opportunities to switch from subsistence to more commercial agriculture; equally, those who will eventually migrate into urban areas should be able to find industrial jobs, and the CU/SES appears better fit for that than continued laissez-faire trade relations with China and the rest of the world.

Yet by contrast to Belarus, where most of the population is both urban and ethnically Belarusian, in Kazakhstan there is also a nationality factor involved. The ethnic Kazakhs became predominant in total population only in the mid 1990s, and lived mostly in rural areas until the mid 2000s, being in minority in both the present (Astana, 20.7%) and the former (Almaty, 12.6%) capitals (Kazakhstan 2005, p. 33). Indeed, Kazakhstan is a very multinational country, featuring over 100 various ethnic groups, some of which can be as small as several dozen people (Kazakhstan 2005, p. 33). Still it is Kazakhs and Russians who dominate in the ethnic composition of this Asian nation, together accounting for 85% in 2008 (Demograficheskiy 2008, p. 26).<sup>36</sup> In this regard, the integration with Russia and Belarus can also contribute to better relations between two largest ethnic communities in the country, preventing them from deterioration as was reportedly the case in the Baltic republics of the former USSR.

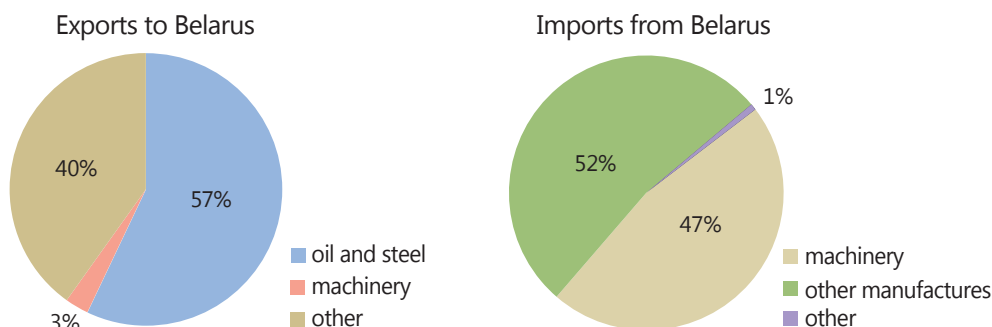
It seems that less industrialized and urbanized Kazakhstan may come across fewer risks from the CU/SES integration than Belarus. Admittedly, the country may experience a trade shock due to more protectionist customs regime, as its agreement to raise import duties to the Russian levels meant that the average tariff for industrial products nearly doubled, from 4.6% to 8.5%, and for agricultural products increased by a third, from 12.1% to 16.7% (IMF 2011, p. 21). This may result in some trade diversion which would not be advantageous for either Kazakhstani consumers or enterprises. As argued by the IMF in 2011, the CU/SES may also jeopardize Kazakhstan's industrialization plans due to increased competition from more established Russian companies (IMF 2011, p. 21). Indeed, at the time the Customs Union was launched, Kazakhstan already had an unfavorable structure of trade with both Belarus and Russia, which may be further aggravated in the future, shown in Figure 5.

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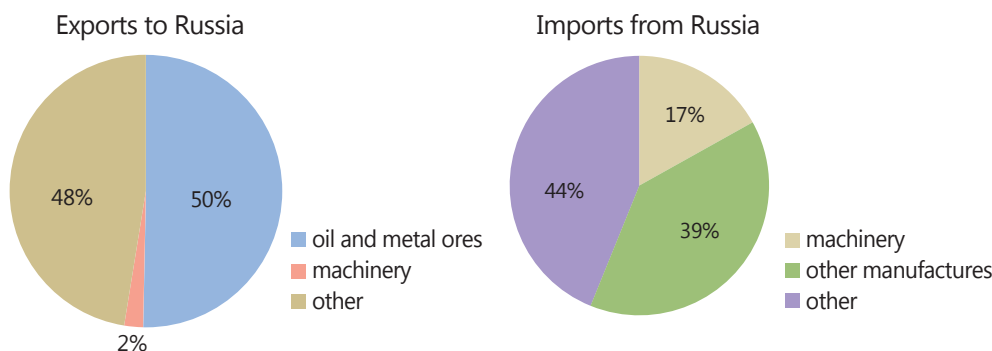
<sup>36</sup> *Demograficheskiy Ezhegodnik Kazakhstana, 2007 [Demographic Yearbook of Kazakhstan, 2007]*, Astana: Agency for Statistics of the Republic of Kazakhstan, 2008

**Figure 5. Structure of Kazakhstan’s foreign trade**

**A. Trade with Belarus, 2010**



**B. Trade with Russia, 2010**



(Source) Author’s calculation, using data available from UN Comtrade.

However, it should be noted that Kazakhstan’s trade with its CU/SES partners is only a reflection of its total trade structure, which has been dominated by resource exports and manufactured goods imports since the mid 1990s as it can be seen in Figure 5. In this regard, even if the CU/SES will lead to more competitive pressures for Kazakhstani industry from the Russian or Belarusian imports, it can be offset by a generally more protectionist trade regime with the rest of the world. And it is competition from the latter, particularly from the Asian and Western producers, which arguably poses the real challenge for the nascent Kazakhstan manufacturing, just as it does for Belarus and Russia. In this regard, the CU/SES can provide a temporary tariff shield for relatively uncompetitive manufacturing industries of its partners, allowing them to enter into

cooperative arrangements and to develop mutually beneficial patterns of industrial specialization. Obviously, it can be seen as a challenge to the forces of globalization and internationalization, but there is hardly an alternative for CU/SES partners to win a better place in the global division of labor.

#### D. Russia's standing

Russia, the largest country in the CU/SES project, has clearly dominated the process of postcommunist integration by the virtue of its size, international role and political ambition. But while in the turbulent 1990s, its efforts to bring together the former Soviet republics were of little practical value, the present attempt to create a Single Economic Space from a Customs Union Mark III has so far been more efficient. With Vladimir Putin set to remain in power for at least a decade, there are no political obstacles on the way for further integration, and his article in the *Izvestia* newspaper in 2011 indicated the ambitions in this regard. Notably, V. Putin (2011) sees CU/SES project as a forerunner to a Eurasian Union, the postcommunist alternative to the European Union, with Russia naturally dominating the scene.<sup>37</sup> However, the success of this endeavor remains unclear, as a lot have changed in the last 20 years of independent postcommunist development, above all within Russia herself as well.

Indeed, on the one hand, Russia has become one of the largest and fastest-growing economies in the world, being included in 2001 in the well-known BRIC (Brazil, Russia, India, and China) group (O'Neill 2001).<sup>38</sup> It can be observed from Figure 6 that its GDP in nominal terms increased five-fold between 1995 and 2008, and seven-fold between 2001 and 2012, remaining high even despite a substantial contraction in 2008.

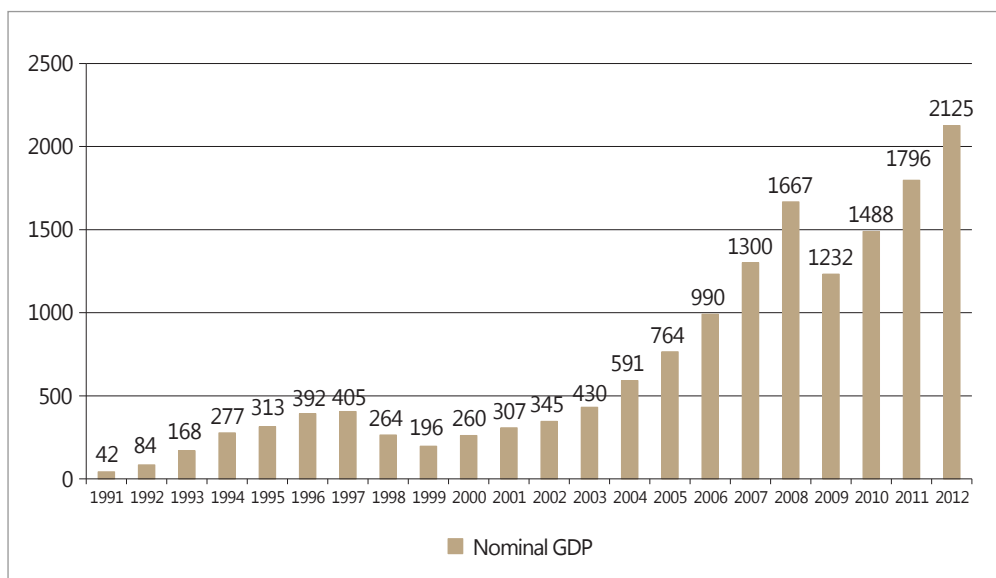
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<sup>37</sup> Putin, Vladimir, "Novyi integratsionnyi proekt dlya Evrazii – budushchee, kotoroye rozhdaetsya segodnya" (New integration project for Eurasia – future which is born today), *Izvestia*, <http://www.izvestia.ru/news/502761>, October 3, 2011.

<sup>38</sup> O'Neill, Jim, "Building better global economic BRICs," *Goldman Sachs Global Economic Paper No. 66*, November 30, 2011, <http://www.goldman-sachs.com/our-thinking/brics/brics-reports-pdfs/build-better-brics.pdf>.

**Figure 6. Russian GDP**

(Unit of measure, billion US dollars)



(Sources) Author's calculation, using data available from EBRD 2011, IMF 2011,<sup>39</sup> and Rossiya 2013.<sup>40</sup>

In fact, Russia now has the 8<sup>th</sup> largest GDP in nominal terms (6<sup>th</sup> largest in PPP terms), having the world's 2<sup>nd</sup> largest rail network, 3<sup>rd</sup> largest electricity consumption, 4<sup>th</sup> largest foreign exchange reserves, and 5<sup>th</sup> largest current account surplus and mobile phones number (BRIC 2013).<sup>41</sup> It also has the 7<sup>th</sup> largest workforce and road network, 9<sup>th</sup> largest population, and 10<sup>th</sup> largest exports (BRIC 2013). On the other hand, though, it ranks only 47<sup>th</sup> in nominal GDP per capita terms, and from being a heavily industrialized country in the Soviet period turned into a resource-based economy, owing to some of the world's largest reserves of natural wealth, particularly oil and gas.

According to the US Geological Survey, Russia is a globally and/or regionally leading producer of such mineral commodities as aluminum, arsenic, asbestos, bauxite, boron, cadmium, cement, coal, cobalt, copper, diamond, fluor spar, gold, iron ore, lime, magnesium compound and metals, mica flake and scrap and sheet, natural gas, nickel, nitrogen, oil shale, palladium, peat, petroleum, phosphate, pig iron, potash, rhenium,

<sup>39</sup> IMF Country Report No. 11/294, <http://www.imf.org/external/pubs/cat/longres.aspx?sk=25262.0>, November 16, 2011.

<sup>40</sup> *Rossiya '2013 – Statisticheskij spravochnik* (Russia-2013 – Statistical Directory), Moscow: Federalnaya sluzhba gosudarstvennoi statistiki, 2013.

<sup>41</sup> "BRIC," <http://en.wikipedia.org/wiki/BRIC>, August 30, 2013.



silicon, steel, sulfur, tin, titanium sponge, tungsten, and vanadium (Levine and Wallace 2008).<sup>42</sup> But similar to Kazakhstan's case, it is oil and gas that have been of particular significance for Russian economy, accounting for about three fifths of total export revenues, and for an estimated 20~25% of the country's GDP (Oomes 2007).<sup>43</sup> With 87.2 billion barrels of proved oil reserves, or 5.2% of global total, and daily production of 10.6 thousand barrels, or 13% of global total, in 2012 Russia was the second largest oil producer in the world (BP 2013, p. 6, 8). Equally robust is the country's position on natural gas: holding the world's second largest after Iran proved reserves of 1163 trillion cubic feet, or 18% of global total, in 2012 it was the second largest gas producer after US, with 592 billion cubic feet, or 18% of the global natural gas output (BP 2013, p. 20, 22).

Exports of natural resources let Russia adjust to the shocks of postcommunist transformation, also contributing to political stability. At the same time, they reduced the incentives for exporting goods with higher added value, notably machinery, or at least chemical products rather than crude oil. Indeed, the structure of Russia's foreign trade resembles that of a low-income developing country, with exports dominated by a few primary commodities heading mainly to developed countries, notably the EU, and imports, composed largely of chemicals, machinery and other manufacturers, coming from the same developed countries and China. It is also obvious that Russia became particularly dependent on exports of hydrocarbons, notably crude oil, and natural gas. Whereas 15 years ago, they took only a third of all Russian exports, in 2010 their combined share was almost one half of total, reflecting two-fold increase of the share of crude oil exports. In the same period, the share of manufactures decreased from over one third of total exports to less than a fifth, with a share of machinery exports contracting by a factor of 2.5 – from 7% in 1996 to less than 3% in 2010 as shown in Table 6.

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<sup>42</sup> Levine, Richard and Glenn Wallace, "The mineral industries of countries of the Baltic region (Estonia, Latvia, Lithuania), Caucasus region (Armenia, Azerbaijan, Georgia), Central Asia region (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan), and Eurasia region (Belarus, Moldova, Russia)," *2008 Minerals Yearbook*, US Geological Survey, December 2010, <http://minerals.usgs.gov/minerals/pubs/country/2008/myb3-2008-aj-am-bo-en-gg-kg-kz-lg-lh-md-rs-ti-tx-uz.pdf>.

<sup>43</sup> Oomes, Nienke and Katerina Kalcheva, "Diagnosing Dutch disease: does Russia have the symptoms?" *Working Paper 07/102*, Washington, D.C.: International Monetary Fund, 2007

**Table 6. Foreign trade of Russia**

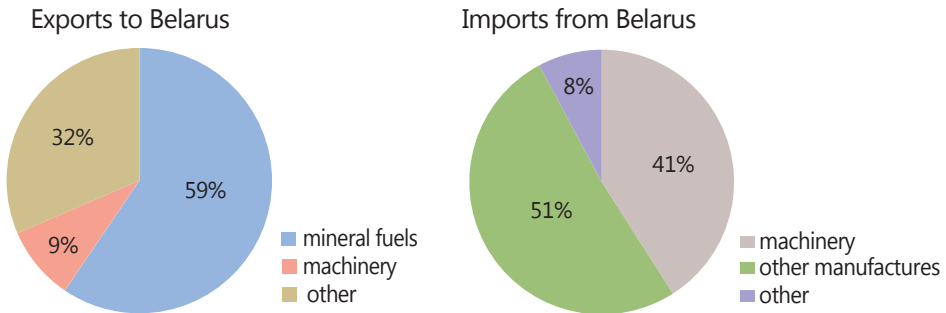
	<b>1996</b>	<b>2000</b>	<b>2005</b>	<b>2010</b>
Foreign trade (billion US dollar)	<b>149.3</b>	<b>137.0</b>	<b>340.2</b>	<b>648.8</b>
Exports (billion US dollar)	<b>88.7</b>	<b>103.1</b>	<b>241.5</b>	<b>400.1</b>
Belarus, % of total	3.8	5.4	4.2	4.5
Kazakhstan, % of total	2.7	2.2	2.7	2.7
EU, % of total	-	56.9	57.9	51.3
China, % of total	4.5	5.1	5.4	5.1
Mineral fuels (SITC 3), % of total	43.1	50.6	61.8	64.4
Crude oil (SITC 3330), % of total	16.9	22.9	33.0	32.3
Natural gas (SITC 343), % of total	15.8	15.6	12.6	11.6
Chemicals, machinery and other manufactures (SITC 5,6,7,8), % of total	34.4	32.0	23.8	19.2
Machinery and transport equipment (SITC 7), % of total	7.0	6.2	4.1	2.9
Imports (billion US dollar)	<b>60.6</b>	<b>33.9</b>	<b>98.7</b>	<b>248.7</b>
Belarus, % of total	4.8	11.0	5.8	3.9
Kazakhstan, % of total	4.8	6.5	3.3	1.8
EU, % of total	-	61.7	71.6	46.1
China, % of total	1.7	2.8	7.4	15.7
Chemicals, machinery and other manufactures (SITC 5,6,7,8), % of total	44.6	57.4	72.5	69.1

(Source) UN Comtrade 2011.

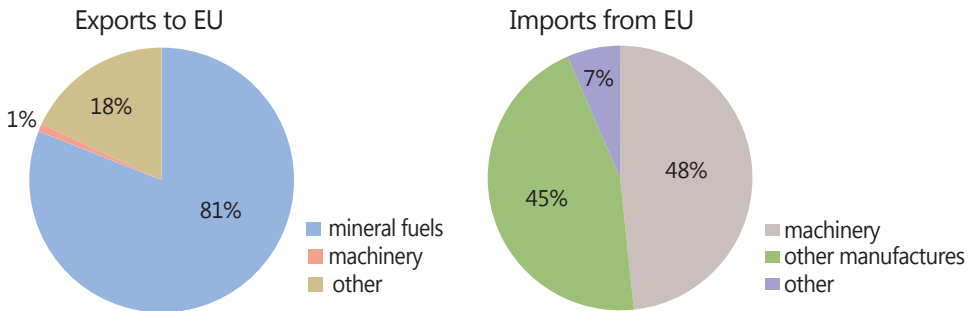
Furthermore, even in trade with its CU/SES partner Belarus, a far smaller country with a lot of common background, Russia appears to have a disadvantageous position, quite similar to that *vis-à-vis* the EU and the rest of the world. Notably, Russian exports to both Belarus and the EU have been dominated by mineral fuels, while imports from these trading partners have largely consisted of manufactures, notably machinery as it can be seen in Figure 7.

**Figure 7. Structure of Russia’s Foreign trade**

**A. Trade with Belarus, 2010**



**B. Trade with EU, 2010**



(Source) Author’s calculation, using data available from UN Comtrade.

According to some specialists, such patterns of foreign trade contributed to economic overheating and underdevelopment of non-resource sectors, notably manufacturing and agriculture (Oomes 2007, p. 3-4). It was also argued that modern Russia is a clear case of so called Dutch disease, a term introduced by The Economist in the 1970s (Economist 2011, p. 76)<sup>44</sup> to describe an economic phenomenon associated with mismanagement of natural resources (Welfens 2005, p. 10-1).<sup>45</sup> Just as in Kazakhstan, the CU/SES project may be viewed in Russia as a catalyst of structural changes in the country’s economy,

<sup>44</sup> Economist (2011) ‘Too strong for comfort: how to live with an overvalued currency?’ 400(8749):76.

<sup>45</sup> Welfens, Paul and Albrecht Kauffmann, “Structural change, natural resources sector expansion and growth in Russia,” in Graham, Edward, Nina Oding and Paul Welfens (eds.) *Internationalization and Economic Policy Reforms in Transition Countries*, Berlin/Heidelberg/New York: Springer, 2005.

capable of reducing its dependence on natural resources. The political economy implications here would be the same – postcommunist integration could boost job creation, foremost in industry and agriculture, thus supporting Putin/Medvedev power tandem.

Indeed, natural resources may bring a lot of budget revenue, but they do not provide a great deal of employment (Welfens 2005, p. 10). In turn, political stability largely depends on decent job opportunities for ordinary Russians, who are finding the labor market less and less welcoming. With over 4 million unemployed in Russia in 2012, only a fifth of them were receiving benefits, providing new jobs is critical for incumbent authorities. While most of these jobs are likely to be in the service sectors, industrial employment has a special political importance in this country. Apart from the politically sensitive memories, the Soviet industrial legacy has left Russia with hundreds of cities still dependant on one or several large industrial enterprises, which provide not only employment, but also basic utilities, such as hot water and heating in winter. According to researchers from the Berlin Institute for Population and Development, 450 Russian cities which is nearly half of total 1090 Russian cities, can be classified as mono-cities, which produced two fifths of the country's GDP prior to the crisis of 2008 (Sievert 2011, p. 40). Closure of enterprises in these places thus not only leaves people without a source of income, it also jeopardizes their survival in winter. And being generally less mobile and entrepreneurial than their Western counterparts, Russian workers are likely to stick to these enterprises for as long as it takes, staging politically remarkable protests should they stop working for any reasons. The case of Pikalyovo is a telling example of political economy risks associated with the decline of industrial employment in Russia's provinces. An industrial town of some 20 thousand people in the Leningrad region, in the summer of 2009 during the St Petersburg's international economic forum when its residents, mostly employed in the cement industry, blocked a nearby federal highway to protest against enterprise closures and related utilities cut-offs (Sievert 2011, p. 80). The closures were reportedly caused by inability of private owners, one of them being the oligarch O. Deripaska, to settle commercial disputes caused by the financial crisis, and prompted personal interference by V. Putin (Pikalyovo 2011).<sup>46</sup>

Indeed, only in the last ten years, Russia lost 2 million industrial and 2.4 million agricultural jobs, with even greater losses in these sectors for the whole period of transformation. Of course, job destruction in industry and agriculture was partly

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<sup>46</sup> "Pikalyovo," <http://en.wikipedia.org/wiki/Pikalevo>, November 24, 2011.

compensated by job creation in services and small businesses, but with overall employment contracting by 7.3 million, or 10%, from 1990 to 2012, it seems that postcommunist reforms have cost Russia dearly in pure labor terms as shown in Table 7.

**Table 7. Employment in Russia**

(in millions)

	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012
<b>Total employment</b>	<b>75.3</b>	<b>66.4</b>	<b>64.5</b>	<b>66.8</b>	<b>67.2</b>	<b>68.0</b>	<b>68.5</b>	<b>67.3</b>	<b>67.6</b>	<b>67.7</b>	<b>68.0</b>
<i>Industry</i>	22.8	17.2	-	18.2	18.0	17.4	16.5	15.3	15.2	15.0	15.0
<i>Agriculture</i>	9.7	9.7	9.0	10.1	9.9	8.9	8.5	8.3	7.7	7.7	7.3

(Sources) Trud 2001, p. 61;<sup>47</sup> Trudovye 2013.<sup>48</sup>

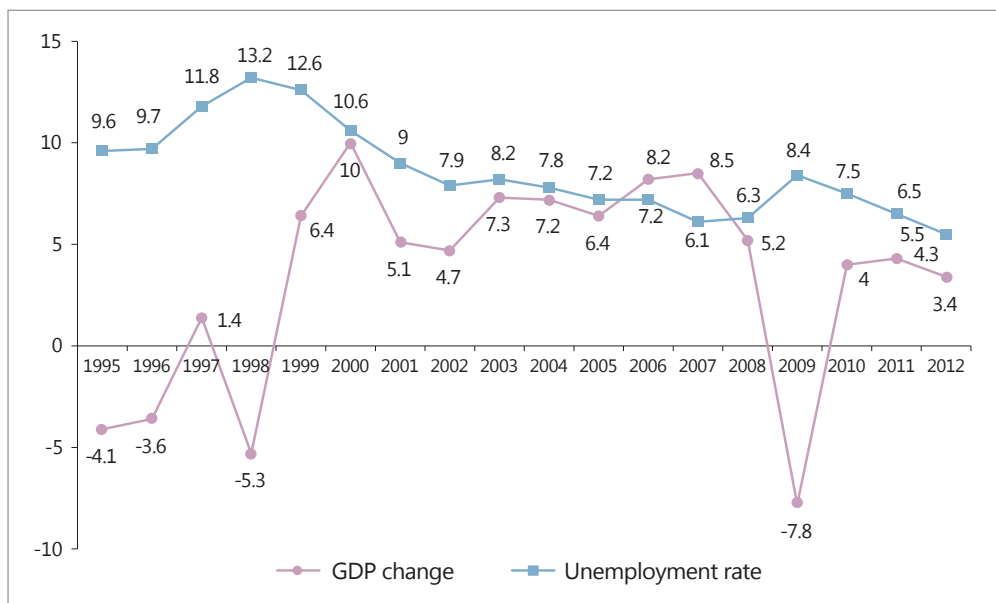
Furthermore, similar to the case of Kazakhstan, strong output growth in Russia from 1999 to 2008, driven largely by exports of natural resources, has not translated into marked reduction of unemployment, once again highlighting the capital rather than labor intensity of natural resources extraction shown in Figure 8.

<sup>47</sup> *Trud i Zanyatost' v Rossii [Labor and Employment in Russia]*, Moscow: State Committee for Statistics of Russian Federation, 2001

<sup>48</sup> "Trudovye resursy" [Labour resources], Federal State Statistics Service of the Russian Federation, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/wages/labour\\_force/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/wages/labour_force/#), September 13, 2013.

**Figure 8. GDP Growth and unemployment in Russia**

(Unit of measure, %)



(Source) Author’s calculation, using data available from Natsionalnye 2013<sup>49</sup>, Trudovye 2013.

Taking into consideration that in the Soviet period, Russia produced nearly everything to satisfy its domestic needs, the present decline of its industry and agriculture, which used to provide nearly half of all jobs, appears problematic both economically and politically. Whereas Belarus, for instance, does not have its own energy and mineral resources, Russia obviously has everything to stage an industrial revival, lacking only good management and technology, as well as appropriate policy decisions. In this respect, the CU/SES may reflect the official commitment to deal with the Dutch disease, and it can be advantageous even if Russians themselves fail to provide the necessary inputs. Indeed, given the preservation of the current economic and political system in Russia, which is almost assured under Putin/Medvedev leadership, foreign investment is not likely to decrease due to the size of the market and its resource base. By contrast, it seems that the CU/SES will make both Russia and its partners a more attractive FDI destination precisely because of relatively higher protection offered by the customs union. In fact, with Russia now being a WTO member, it can offer investors a distinctive

<sup>49</sup> “Natsionalnye scheta” [National accounts], Federal State Statistics Service of the Russian Federation, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/accounts/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/accounts/#), September 13, 2013.

mixture of market size, resources, protection, and free trade.

## E. Public debate and political economy implications

Without a doubt, all the advantages mentioned at the end of preceding subsection can be nullified by inadequate property rights and investment protection, but these issues have always been acute for Russia and its CU/SES partners, and they arise from a bigger problem, lack of pluralism in the region. To be sure, any discussion of issues relating to postcommunist integration, either in the local media or in the Russian-language academic literature, tends to be done in a positive way, with nobody daring question its rationale or be critical about details. For example, when Belarus had to impose Russia-tailored restrictive duties on used cars in 2011, neither the official nor the opposition media in the country raised the issue as potentially disastrous. In the following year, the duties increased, Belarusians imported nearly half a million used cars from the West, several times more than the usual, spending around 3 billion US dollar (Krapivina 2011).<sup>50</sup> Given that the country already had a 10 billion trade deficit in 2010, this additional demand for foreign currency might have been the final straw to destabilize the currency exchange market in the early 2011. And as foreign currency started to disappear from currency exchange outlets of Belarusian banks, many people started panicking, making advance purchases of all sorts of consumer goods. As a result, inflation soared, Belarusian ruble was officially devalued by 56 per cent in May, and then by additional 52 per cent in October 2011 (Kozhemyakin 2011).<sup>51</sup> Average wages collapsed in US dollar terms, from 500 at the end of 2010 to 270 at the end of 2011, and started to recover only in 2012 when it approached 600 US dollar by the end of 2013.

One can suppose then that with more open political process, Belarus could have a more critical and profound debate on the risks associated with the CU, and perhaps could have avoided the macroeconomic instability it came across in 2011 as a cost for the SES (Lukashenka 2011).<sup>52</sup> Indeed, presidential elections in the country at the end of 2010

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<sup>50</sup> Krapivina, Liliya, "Rekordnoye kolichestvo avtomobilej vvezeno v Belarus' za I polugodiye 2011 goda – bolee 250 tys." (Record number of cars was imported into Belarus during first half of 2011 – more than 250 thousand), *Belta*, 7 July 2011, [http://www.belta.by/ru/all\\_news/economics/Rekordnoe-kolichestvo-avtomobilej-vvezeno-v-Belarus-za-I-polugodie-2011-goda--bolee-250-tys\\_i\\_562712.html](http://www.belta.by/ru/all_news/economics/Rekordnoe-kolichestvo-avtomobilej-vvezeno-v-Belarus-za-I-polugodie-2011-goda--bolee-250-tys_i_562712.html).

<sup>51</sup> Kozhemyakin, Andrei, "Vtoraya devalvatsiya nakroyet belorusov volnoi novyh tsen" (Second devaluation will cover Belarusians by a wave of new prices), *Belorusskie Novosti*, 21 October 2011, [http://www.naviny.by/rubrics/economic/2011/10/21/ic\\_articles\\_113\\_17555/](http://www.naviny.by/rubrics/economic/2011/10/21/ic_articles_113_17555/).

<sup>52</sup> Lukashenko, Aleksandr (2011) "O sud'bakh nashei integratsii" (On destinies of our integration), *Izvestia*, 17 October 2011, <http://www.izvestia.ru/news/504081>.

offered a good opportunity to sparkle that debate, but none of the 9 alternative candidates seriously criticized the integration. Similarly absent was a critical and profound debate on the pros and cons of the CU/SES in Kazakhstan and Russia during presidential and parliamentary campaigns in 2011 and 2012.

Based on the trade and economic data, it looks like only Belarus needs the CU/SES project to meet its current economic needs. Specifically, it would facilitate half of this country's total foreign trade turnover by easing access to the larger manufacturing markets and ensuring cheaper supplies of natural resources. On the other hand, its partners depend far less on mutual trade, and it appears that their economic interests in integration are more future-oriented. Indeed, at present both Kazakhstan and Russia are major exporters of natural resources and importers of finished goods, being resource-based economies with clear symptoms of the Dutch disease. As things stand, then, their economic interests may run counter to those of more industrialized Belarus, thus jeopardizing the whole CU/SES project. However, the very fact that the latter is moving on indicates that these countries may see the CU/SES as an opportunity to diversify their economies by shielding their industrialization from foreign competition.

As it turns out, then, postcommunist integration may have quite important political economy implications for Belarus, Kazakhstan, and Russia. Indeed, the CU/SES would amount to geographically the largest common trade area in the world, open for internal but relatively restricted for external competition. So far, the latter proved a serious challenge for the development of manufacturing industry and agriculture in Kazakhstan and Russia, as was demonstrated by the structure of their foreign trade. Only Belarus managed to preserve the bulk of its industrial and agricultural capacity, but being the smallest and largely state-run economy in the CU/SES, it hardly poses a competitive threat for its partners. It is assumed then that Kazakhstan and Russia need to revive their manufacturing and agriculture sectors, not only to correct enormous trade imbalances, but to boost employment opportunities for the electorate which is getting increasingly anxious about the lack of decent and adequate jobs. While in the last twenty years, the services could compensate for huge job losses in industry and agriculture, their potential seems to be running out, as there are no institutional or infrastructural conditions for the transformation of the CU/SES countries into developed post-industrial economies. Indeed, in the aftermath of the USSR breakup, there might have been a genuine need for more vendors, taxi drivers, or café owners, but even greater was a need for all sorts of quality and affordable consumer goods. As time has shown, it proved much easier to meet the former than the latter need, perhaps because buying cheap consumer goods



in China, Turkey or Poland and selling them in largely unregulated markets (bazaars) across the former Soviet Union did not require special qualifications or managerial efforts necessary for organizing/reorganizing their own manufacturing. But that also meant that industrialization in this region that started in the Soviet period, has not been completed, and the CU/SES may be considered as an attempt to do so, even if it is not officially acknowledged as such.

Another important political economy implication of the postcommunist integration is the link between employment opportunities and political stability. It is obvious that political elites in all three partner countries fear losing power, and seek for ways to consolidate it at the grass roots level. No doubt that decent employment opportunities are essential in this regard, and given the general level of workforce qualifications and business infrastructure in the region, these opportunities are likely to be concentrated in industry and agriculture. Up until recently, these sectors have been largely neglected in Kazakhstan and Russia, at first because of economic instability in the 1990s, and then due to commodities boom of the 2000s. However, the global economic crisis might have prompted the leaders of the CU/SES members to reconsider the political economy role of industry and agriculture. Indeed, by employing relatively less educated and entrepreneurial parts of the population, these sectors not only satisfy their material needs, but can also substantially boost the national spirit, the so called feel-good factor decisive for electoral victories. Given the apparent authoritarian tendencies in all partner countries, their leaders may require a lot more popular support to validate their grip on power than would be sufficient in a pluralist representative democracy, where voter preferences tend to be diffused along competing party lines. In other words, because of its anticipated positive labor and other economic effects, the CU/SES can be considered a political economy instrument facilitating incumbent elites in the region prone to instability due to numerous social and economic problems accumulated since the break-up of the USSR.

To back up this argument, one can juxtapose Belarus and those CIS countries, where formal political processes were overtaken by so called color revolutions, notably Georgia, Kyrgyzstan, and Ukraine. It is argued that these revolutions were attempts by new proprietary groups to raise the masses against corrupt politicians and their sponsors, the oligarchs. The revolutionaries managed to grasp power for some time, but failed to make good of it, most likely because they could not meet the popular expectations. Belarus also had several revolutionary attempts, but they were not successful. While the country's opposition and its Western supporters explain this by the popular fear of repressions, it

seems that Belarusians did not take to the streets to oust Lukashenka because his policies provided them with secure if low-paid employment, including in industry and agriculture, and did not allow oligarchs, or the super-rich, to irritate the ordinary people (the latest incident with the treatment of Uralkaliy managers and owners is a telling example).<sup>53</sup> Indeed, if the economic, social and political situation in Belarus was really as bad as claimed by the country's opposition and some Western experts, it is hard to believe that president Lukashenka could prevent by repression a revolution similar to any of those which took place in Georgia, Kyrgyzstan or Ukraine in the last decade.

## IV. Conclusion

The current stage of postcommunist integration in the form of the Customs Union and Single Economic Space is remarkable both in scope and timing. For the first time in more than two decades, Russia and its partners exhibit clear political commitment to accomplish their integration project quickly and without delay. The speed in which the CU/SES is proceeding at the moment suggests that apart from economics, there is a wider political agenda. It was argued that postcommunist integration has a potential not only to boost intra-regional trade, but also to facilitate industrial and agricultural development, creating job opportunities and providing positive background for elections. Indeed, Belarus had presidential elections in December 2010, Kazakhstan in April 2011, and in Russia in March 2012. Given the ongoing world economic instability, often referred to as the crisis in the local media of the integrating countries, there is obviously a need for some big positive political news that could inspire ordinary voters. It seems that both the Customs Union, revived immediately after the first strikes of the global financial crisis in 2009, and the Single Economic Space to be launched in the near future, have provided precisely the right sort of news for political elites in all three partner states, but especially for Vladimir Putin.

No doubt that only time can judge the current integration endeavor in the former USSR, but its major political economy implications are already visible. On the economic

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<sup>53</sup> Armitage, Jim, "Belarus and Russia row over potash raises fear of a trade war," *The Independent*, 30 August 2013, <http://www.independent.co.uk/news/business/news/belarus-and-russia-row-over-potash-raises-fear-of-a-trade-war-8790779.html?origin=internalSearch>.

side, it should benefit local industry and agriculture through increased market size, internal competition and external protection. Both trade creation and trade diversion are likely to occur, and will mainly concern manufactures, which are now predominantly imported from the outside world. Increased demand for local manufactured goods, in turn, should translate into more blue-collar jobs and better social security for the workers of Belarus, Kazakhstan, and Russia. On the political side, though, this may play in the hands of the increasingly authoritarian political regimes. And while the ordinary Belarusian, Kazakhstani, and Russian voters may tolerate it as long as they have jobs and social security, the economic distress in Belarus in 2011 showed that lack of democratic debate on the pros and cons of the postcommunist integration can be very costly, particularly for the very ordinary people.

Its major political economy implications are as follows;

- On the economic side, it should benefit local industry and agriculture through increased market size, internal competition, and external protection.
- There is likely to be both trade creation and trade diversion, and it will concern mainly manufactures, which are now predominantly imported from the outside world.
- Increased demand for local manufactured goods, in turn, should translate in more blue-collar jobs and better social security for the citizens of Belarus, Kazakhstan and Russia.
- On the political side, though, this will inevitably play in the hands of the increasingly undemocratic political regimes in those countries.
- While the ordinary Belarusian, Kazakhstani and Russian voters may tolerate it for a while, the economic distress in Belarus in 2011 showed that integration can be very costly, particularly for the same ordinary people.
- To avoid the repeat of 2011 Belarus scenario, and to increase democratic legitimacy of the postcommunist integration as a whole, more public debate on its costs and benefits should be encouraged, both in the local media and at the international arena.
- What seems really in deficit with the CU/SES integration project is political commitment and discipline – politicians have often been signing treaties which were not implemented later, and this stems not just from a visible deficit of common values and difference in interests, but also from a lack of acknowledgement that any sustainable integration (like the EU project, for example) should start from the

economic basis including in the energy sphere, only then move on into other areas, whether social, or political ones.

- For the CU/SES this means that delaying establishment of a common energy market to 2025 yet again reflects internal conflict of interests which may hinder the whole process no matter what name you attach to it.

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