

## **Towards a Eurasian Economic Union: The challenge of integration and unity**

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### **Abstract**

In the lead-up to the creation of a Eurasian Economic Union in 2015, the Customs Union and the Common Economic Space between Russia, Belarus and Kazakhstan represent two elements of the most ambitious regional integration project launched in the post-Soviet era since 1991. This CEPS Special Report examines both the potential and the limits of Eurasian economic integration. For the purpose of assessing the Eurasian integration process, CEPS applied a modified version of a framework first developed by Ernest B. Haas and Philippe C. Schmitter in 1964 to project whether economic integration of a group of countries automatically engenders political unity. Taking the data available for the early stages of the European integration process as a benchmark, the results for the Customs Union and the Common Economic Space point to a rather unfavourable outlook for Eurasian economic integration.

The study was carried out by a team of researchers from CEPS. Steven Blockmans is a CEPS Senior Research Fellow and Head of the EU Foreign Policy unit. Hrant Kostanyan is an Associate Research Fellow and Ievgen Vorobiov is an intern at CEPS. Support provided by the Russian Union of Industrialists and Entrepreneurs is gratefully acknowledged.

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# CONTENTS

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- Executive summary ..... i
- 1. The Eurasian integration process: models and institutions..... 1
- 2. Aim of the study and methodological justification ..... 2
- 3. Comparing Eurasian and European economic integration ..... 4
  - 3.1 Background conditions..... 4
    - 3.1.1 Size of units ..... 4
    - 3.1.2 Distance between major economic centres ..... 6
    - 3.1.3 Rates of transaction..... 6
  - 3.2 Formation conditions..... 9
    - 3.2.1 Implementation of common policies..... 9
      - 3.2.1.1 Elimination of intra-bloc tariffs ..... 10
      - 3.2.1.2 Common tariff policy..... 10
      - 3.2.1.3 Eliminating non-tariff barriers ..... 11
    - 3.2.2 Supranational institutions..... 13
      - 3.2.2.1 The Eurasian Economic Commission..... 13
      - 3.2.2.2 The Court of Eurasian Economic Community ..... 17
  - 3.3 Process conditions ..... 19
    - 3.3.1 Decision-making mode..... 19
    - 3.3.2 Economic effects of Eurasian integration..... 22
      - 3.3.2.1 Trade creation effects..... 23
      - 3.3.2.2 Trade diversion effects ..... 25
      - 3.3.2.3 Effects on the trade structures of member states ..... 26
- 4. Conclusions and recommendations ..... 29
- References ..... 31

## List of Figures

Figure 1. Trade structure of Russia's total exports (left) and exports to CIS countries (right), 2009.....	7
Figure 2. Dynamics of Belarus' share of exports to Russia in total exports, 2004-2010 .....	8
Figure 3. The infringement procedure initiated by the Eurasian Economic Commission .....	16
Figure 4. The decision-making process in the CU and the CES .....	20
Figure 5. Dynamics of Russia's exports of ferrous metals to major markets, thousand \$US. ....	24
Figure 6. Dynamics of Russia's exports of machinery and equipment to major markets, thousand \$US.....	24
Figure 7. Dynamics of Russia's imports of machinery and equipment from EurAsEC, thousand \$US.....	25
Figure 8. Shares of meat products imported from EurAsEC countries and the EU, 2010-2012.....	26
Figure 9. The comparison of Russia's export structure in machinery and equipment from 2010 to 2011.....	27
Figure 10. Structure of Russia's exports of machinery and equipment in mid-2012 .....	27
Figure 11. The dynamics of the share of Belarus' exports to other CU members, 2008-2012 ..	28

## List of Tables

Table 1. Comparison of the basic characteristics of the two economic blocs.....	5
Table 2. Comparison of the distances between major economic centres in the EEC and the EAEU .....	6
Table 3. Structure of Russia's exports in 2006-2010.....	6
Table 4. Comparison of the functions of the Eurasian Commission and the European Commission.....	13
Table 5. Comparison of the decision-making structures in the CU/CES and the EEC .....	21
Table 6. Share of Russia's imports of machinery from EurAsEC in comparison to major suppliers .....	26
Table 7. Conditions underpinning successful implementation of economic unions (Haas& Schmitter) .....	30

## List of Abbreviations

APEC	Asia-Pacific Economic Cooperation
CES	Common Economic Space
CET	Common External Tariff
CIS	Commonwealth of Independent States
CU	Customs Union
EBRD	European Bank for Reconstruction and Development
ECJ	European Court of Justice / Court of Justice of the EU
EEC	European Economic Community
EEU	Eurasian Economic Union
EurAsEC	Eurasian Economic Community
FTA	Free Trade Agreement
NTB	Non-tariff barrier
SPS	Sanitary and phytosanitary measures

## Executive summary

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Observers of the post-Soviet space have seen reintegration efforts proliferate among different constellations of countries belonging to the Commonwealth of Independent States. This has resulted in the creation of several structures with partly overlapping memberships, different integration objectives and varying modes of governance. The Collective Security Treaty Organization, the GUAM Organization for Democracy and Economic Development and the Organization of Black Sea Economic Cooperation are cases in point. These arrangements have provided platforms for continuous interaction and socialisation among countries. However, both the speed and the level of integration within these structures vary greatly and none of the arrangements has reached the levels of integration attained within the EU.

In the lead-up to the creation of a Eurasian Economic Union (EEU), foreseen for 2015, the Customs Union (CU) and the Common Economic Space (CES) between Russia, Belarus and Kazakhstan represent two elements of the most ambitious regional integration project launched in the post-Soviet space since 1991. An initiative conceptualised by President Nazarbayev of Kazakhstan in 1994, the institutionalisation of the EEU has gained momentum since Vladimir Putin promoted it in the newspaper *Izvestia* on 4 October 2011. Reactions of policy-makers and analysts have ranged from describing the plan as a pipedream to the next real thing.

Leaving politics aside, how can one assess whether or not the Eurasian integration effort is economically viable? The best way forward is to select practical indicators to analyse the existing Customs Union and CES, so as to glean insights into the levels of economic integration and project them onto the model of the future EEU. In this regard, an adapted version of the framework conceptualised by Haas and Schmitter in 1964, which has been applied to assess the early stages of the European integration process, is a helpful tool.

The indicators outlined in the adapted model are classified in three groups i) background conditions, ii) formation conditions and iii) process conditions of economic integration models. The background conditions include the size of units (e.g. population, GDP), distance between economic centres and initial rates of transaction (i.e. share of regional exports in overall foreign trade). The formation conditions assess the implementation of common policies and the power of supranational institutions in these policy areas. The process conditions evaluate the change likely to be brought about by the functioning of the integration structures in terms of the governance mode and the economic effects attained.

When testing these indicators, the relative size of the units and the distance between economic centres present tougher background conditions for Eurasian economic integration than those experienced during the earlier years of the European integration process. The analysis of the current rates of transaction between the members of the future EEU also shows an imbalanced pattern of regional trade integration. Coupled with rather slow dynamics for the movement of capital and labour force, this starting-point makes the creation of a fully-fledged economic union between Russia, Belarus and Kazakhstan more challenging than the one undertaken by the six founding states of the European Economic Community.

The analysis of the implementation of the powers attributed to the supranational institutions of the future EEU in designated common policy areas shows less than favourable process conditions for the EEU. The Eurasian Economic Commission's competences and the EurAsEc

Court's jurisdiction are rather limited in comparison to those which allowed the European Commission and the Court of Justice to build a strong law-based community. The governance mode in the current Customs Union and CES is predominantly intergovernmental. Moreover, the outcome-based transactions that were largely positive for the European integration process (investment flows, migration changes, dynamics of intra-union trade volumes in the most important sectors) are ambiguous for the EEU, and unlikely to change much in light of the preceding considerations.

In sum, when applying the model to the current Customs Union and Common Economic Space between Russia, Belarus and Kazakhstan, and when comparing the findings with the data available for the early stages of the European integration process, the conclusion points to a rather uncertain future for economic integration within the context of the EEU.

# **Towards a Eurasian Economic Union: Integration and cooperation**

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## **1. The Eurasian integration process: models and institutions**

The rapid proliferation of regional economic integration models in the latter half of the 20<sup>th</sup> century is often attributed to the success of the European Economic Community (EEC) established in 1957.<sup>1</sup> The substantial increase in intra-EEC trade in the 1960s inspired countries on other continents to set up regional organisations: ASEAN in South East Asia (1967), ECOWAS in West Africa (1975), MERCOSUR in Latin America (1991) and NAFTA in North America (1994), to name but a few. Integration within these groupings has been limited to free trade agreements, however, with the notable exception of MERCOSUR establishing its customs union in 1995.

Over the last two decades we have also witnessed a proliferation of reintegration efforts among different constellations of countries belonging to the Commonwealth of Independent States (CIS). This has given rise to the creation of several structures with partly overlapping memberships, different integration objectives and varying modes of governance. The Collective Security Treaty Organization, the GUAM Organization for Democracy and Economic Development, and the Organization of Black Sea Economic Cooperation (with a membership extending into southeast Europe) are cases in point.<sup>2</sup> These arrangements have provided platforms for continuous interaction and socialisation among countries in the post-Soviet space. Both the speed and the level of integration within these structures vary greatly. None of these arrangements has reached levels of integration attained within the European Union (EU), which operates by way of both supranational and intergovernmental governance modes.

The focus of this CEPS Special Report are the Customs Union (CU) and the Common Economic Space (CES) between Russia, Belarus and Kazakhstan, which represent two elements of one of the most ambitious regional integration projects launched in the post-Soviet space since 1991: the creation of a Eurasian Economic Union (EEU) foreseen for 2015. An initiative conceptualised by the President of Kazakhstan, Nursultan Nazarbayev in his speech at Moscow's State University in March 1994, the institutionalisation of the Eurasian Economic Union has gained momentum since the publication of an article by President, then Prime Minister, Vladimir Putin in the newspaper *Izvestia* on 4 October 2011.<sup>3</sup>

The first step towards the creation of the EEU was the establishment in 2010 of the Customs Union, which encompasses a common customs territory and legislation (the Customs Code, with effect from 1 July 2010), a single commodity nomenclature of foreign economic activity, common customs tariff and non-tariff regulation measures, as well as common procedures

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<sup>1</sup> See, for instance, Mattli (1999) and Schiff & Winters (2003).

<sup>2</sup> See Libman and Vinokurov (2012).

<sup>3</sup> This was followed by similar publications by the President of Belarus Alexander Lukashenka (*Izvestia*, 17 October 2011) and the President of Kazakhstan Nursultan Nazarbayev (*Izvestia*, 25 October 2011).

for customs clearance and control. The Treaty on the Commission of the CU (6 October 2007) established a supranational body composed of one member from each state at the level of deputy head of government. The votes in the Commission were distributed as follows: Belarus – 21.5%; Kazakhstan – 21.5%; Russian Federation – 57%. The Commission of the CU includes the Committee for Regulation of Foreign Trade Issues, composed of two representatives from each member state. The member states also dispatched at least five specialists to the Council of Experts. The Secretariat provides informational and technical support to the CU Commission itself and the Supreme Eurasian Economic Council, which meets at the level of heads of state or government. The Secretariat is composed of the Executive Secretary and one deputy from each of the member states. Its seat is in Moscow.

The ratification of the Action Plan for the establishment of the Common Economic Space in December 2010 marked the second phase of the Eurasian integration process. The CES, which kicked off in January 2012, aims to ensure the effective functioning of the common market for goods, services, capital and labour, and to establish coherent industrial, transport, energy and agricultural policies. The CES envisions further regulatory convergence and harmonisation of national laws in the areas established by the agreements that constitute the legal framework of the CES. The development and implementation of a coherent economic policy; transition to the harmonisation of the main macroeconomic indicators of the member states; deepening of monetary cooperation; collaboration on migration policy and ensuring interoperability of standards of education are also an integral part of the CES. The project also foresees cooperation between parliaments, business communities and people, including in the sphere of culture, the formation of effective patterns of inter-regional and cross-border collaboration, and the development of cooperation in the sphere of foreign policy.

## 2. Aim of the study and methodological justification

This study will analyse the Customs Union between Russia, Belarus and Kazakhstan and the Common Economic Space, paying particular attention to the scope of the Eurasian Economic Commission's activity, the (expected) levels and impact of economic integration, and the external dimension of these models of integration. These findings will be contrasted with a review of the early stages of the European economic integration process, its objectives, structures, instruments, levels and effects of integration. The study will then turn to the initiative of establishing the Eurasian Economic Union and will examine the envisaged objectives, membership and governance modes of the organisation. Finally, the analysis will be geared towards answering the key question: what lessons can the actors in the Eurasian integration process learn from the lessons already learned from the European integration process? As such, this CEPS Special Report does not dwell on areas already covered by other, excellent studies: the politics driving the Eurasian economic integration process and the legal and political dilemmas for countries which have been offered a membership perspective.<sup>4</sup>

For our research purposes, we use the following broad definition of a *regional integration agreement*: an agreement between two or more independent states to remove tariffs on intra-bloc trade, as well as to eliminate non-tariff barriers, liberalise investment and coordinate other policies.<sup>5</sup> The deepest form of such integration is an economic union, which necessitates the creation of shared institutions. The study distinguishes between three major levels of economic integration:

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<sup>4</sup> See, e.g., Shumylo-Tapiola (2012), resp. Van der Loo & Van Elsuwege (2012).

<sup>5</sup> Based on the characteristics identified by Schiff & Winters (2003), World Bank.

- 1) free trade agreements (FTAs): eliminate customs tariffs on intra-bloc trade without imposing an external tariff for external trade;
- 2) customs union: removes tariffs on intra-bloc trade and imposes a common external tariff for external trade;
- 3) economic union: eliminates non-tariff barriers and converges major economic policies to establish a common market.

The opportunities and challenges of transition from the current Customs Union to a fully-fledged economic union within the Eurasian integration process are the focal point of our analysis. Going by the current levels of economic integration in the framework of the CU and CES, a comparison will be made with early integration efforts in the context of the European Economic Community (EEC).

In order to compare the levels and dynamics of economic integration in the CU/CES and the EEC, the study uses a mix of data derived from official documents, academic and policy-oriented sources. Two caveats are in order. Firstly, the case studies have different empirical bases. The EEC had been in place for over three decades before the European Union was created. Conversely, the establishment of the Customs Union and the Common Economic Space is a recent development with less empirical data available from reliable sources. Secondly, the setting up of the Eurasian Economic Union is a work in progress. We can therefore only draw conclusions by extrapolating and comparing data. The proposed methodology will take these evident limitations into account.

The choice for an analytical framework is informed by two other important considerations. First, it should offer viable indicators for comparing the regional integration models of the CU/CES/EEU and the EEC/EU, while bridging their different historical trajectories and internal characteristics. Secondly, it should provide a tool for analysing the integration models as dynamic processes rather than offering a snapshot at a particular point in time.

It is for these reasons that we have adopted the analytical framework developed by Haas & Schmitter in their seminal article of 1964. This framework will allow us to analyse the early stages of European integration and compare its major elements to the peculiarities of the Eurasian integration process. The added value of this framework is that it combines different variables, in particular structural economic conditions and modes of governance, which appear crucial in the analysis of the nascent Eurasian Economic Union. Such an approach has been supported by more recent research in the field of integration studies. For instance, Badinger (2001) also suggests that the measurement of economic integration should draw on the “elements of positive integration”, such as the creation of common institutions.

Drawing on the methodological insights offered by Haas & Schmitter, we will divide the indicators of integration into three groups: background conditions, formation conditions and process conditions, each depending on the stage of economic integration.

1. **Background conditions** for economic integration models aim to identify and compare the starting points of the integration processes, i.e. the baselines before functioning customs unions are launched: the European Economic Community in 1957 and the Customs Union of Russia, Belarus and Kazakhstan in 2010. The background conditions include the size of units, distance between economic centres and initial rates of transaction.<sup>6</sup> This part of the analysis mainly involves quantitative methods.

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<sup>6</sup> The latter indicators somewhat overlap with the “market-integration” indicators suggested by Vinokurov (2010) to analyse the Eurasian integration process, such as trade integration and labour migration. Such indicators are included in the broader category of indicators termed “rates of

2. **Formation conditions** scrutinise the principles and methods by which the economic integration model is managed, as they influence the efficiency of the operation. Given the governance mode enshrined in the current treaties, we focus on two major indicators: the implementation of common policies and the powers of supranational institutions in these policy areas. This part of the analysis relies on qualitative methods.
3. **Process conditions** evaluate the changes likely to be brought about by the functioning of the integration structures, in terms of the governance mode and the economic effects attained. Conclusions about the governance mode can be drawn from a comparison of the national and supranational competences in the decision-making process. The expected economic effects of integration are outlined by comparing the empirical data on the EEC integration effects with changes in the trade patterns spurred by the early stage of the Eurasian integration. Hence, this part of the analysis will use both qualitative and quantitative methods.

These groups of indicators inform the structure of Section 3 of this report. Section 3.1 outlines the background conditions to evaluate how complementary the economies of the envisaged Union are before the introduction of the Customs Union as a first stage of integration. Section 3.2 assesses the progress in implementing common policies, focusing on the common tariff policy, and questions the adequacy and the role of the newly established supranational institutions in the next stages of the integration process. Section 3.3 summarises the institutional changes underpinning governance in the Customs Union and analyses the instant economic effects unleashed by the integration efforts over the last two years. Finally, Section 3.4 concludes by highlighting the challenges identified in the process of the Eurasian integration and proposing tentative measures to overcome them.

### 3. Comparing Eurasian and European economic integration

#### 3.1 Background conditions

In order to estimate the viability of the envisaged economic union, we compare it with the early stages of the EEC according to the three background factors outlined in the literature review: i) relative size of constituting units; ii) distance between major economic centres; and iii) rates of transaction.

##### 3.1.1 Size of units

The main factual data, provided in Table 1, lead us to conclude that the EEC (at the beginning of the integration process) and the CU/CES have comparable levels of total population size (167 million and 169 million respectively), even though their geographical areas differ drastically (the CU is about 17 times larger than the EEC was in 1957). The internal imbalances of populations and area size are obvious: while the EEC was composed of three comparatively large member states, two small member states and one microstate, the EEC comprises one very large member state (Russia), which accounts for over 84% of the total population and 85% of the total area, and two small member states, whose population and land mass are significantly smaller. By contrast, the share of the most populous member state, West Germany, was 32% of the total EEC population, reasonably balanced by the populations of France and Italy. Russia's market size too is dominant in the CU/CES, again with a share of 84%. The disparity in volume between the economies is even more striking:

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transaction" in this research, because we aspire to make a clear distinction between the starting conditions of economic integration and the outcomes (which are dealt with in Section 3).

Russia's GDP accounted for over 88% of the Customs Union's GDP in 2009, while West Germany's share barely exceeded 40% before the creation of the EEC.

Table 1. Comparison of the basic characteristics of the two economic blocs

Criteria	EEC (as of 1957)	EEU (2010)
Members	Federal Republic of Germany, Italy, France, Netherlands, Belgium, Luxembourg	Russian Federation, Belarus, Kazakhstan
Area size	1.17 mln sq km, including: - France: 547, 000 sq km - Italy: 301, 000 sq km - FRG: 248, 000 sq km - Benelux: 76, 657 sq km	20 mln sq. km, including: - Russia: 17,1 mln sq km - Kazakhstan: 2,7 mln sq km - Belarus: 207,000 sq km
Population (i.e. market size)	Total: 167 mln <sup>7</sup> , including: - 3 big member states (FRG, Italy, France) - 3 small member states	168,9 mln, including: - Russia: 141,9 mln <sup>8</sup> - Kazakhstan: 16.4 mln <sup>9</sup> - Belarus: 9.5 mln <sup>10</sup>
Population share of biggest MS	West Germany <sup>11</sup> - 32%	Russia - 84%
Share of the biggest member state in total GDP	West Germany - about 40% <sup>12</sup>	Russia - 88%

We can thus conclude that the EEC demonstrated more homogeneity in terms of size of populations, territories and economies than the members of the CU, which are strongly dominated by Russia. This imbalance is likely to have implications for the distribution of power within the envisaged Eurasian Economic Union.

As the experience of the EU has shown, the increase in the size of the market offers companies and consumers a number of advantages: most notably economies of scale, which lower costs for producers and can thus increase their competitiveness in foreign markets. However, this benefit is contingent on the success of eliminating non-tariff barriers in intra-union trade. Secondly, the increase in intra-union competition is likely to benefit consumers, provided that the necessary competition laws are put in place by the supranational authority.

Overall, the increase in market size may be deemed a favourable impetus to the development of economic unions. However, the adverse effects that result from the asymmetries in unit size should be negated by adequate competition policies and suitable governance structures.

<sup>7</sup> Eurostat data cited in ([http://www.ined.fr/fichier/t\\_telechargement/30959/telechargement\\_fichier\\_fr\\_population.europe\\_27.pdf](http://www.ined.fr/fichier/t_telechargement/30959/telechargement_fichier_fr_population.europe_27.pdf).)

<sup>8</sup> Data taken from Demographic Yearbook of Russia, 2010, Rosstat ([http://www.gks.ru/doc\\_2010/demo.pdf](http://www.gks.ru/doc_2010/demo.pdf), p.25).

<sup>9</sup> Kazakhstan Statistic Agency ([http://www.stat.kz/digital/naselsenie/Pages/Archieve\\_2010.aspx](http://www.stat.kz/digital/naselsenie/Pages/Archieve_2010.aspx) (Kazakh)).

<sup>10</sup> National Statistic Committee of Belarus (<http://belstat.gov.by/homep/ru/indicators/regions/1.php> (Russian))

<sup>11</sup> West Germany's population was 53.6 mln. Data quoted from *Statistisches Jahrbuch der Bundesrepublik Deutschland*, retrieved from (<http://www.populstat.info/Europe/germanwc.htm>).

<sup>12</sup> Data from Broadberry & Klein (2011), p. 22 ([http://www.cepr.org/meets/wkcn/1/1699/papers/Broadberry\\_Klein.pdf](http://www.cepr.org/meets/wkcn/1/1699/papers/Broadberry_Klein.pdf)).

### 3.1.2 Distance between major economic centres

According to the gravity model of international trade, the distance between economic centres of two states exerts significant influence on the dynamics of economic integration, as it impacts on the transportation costs between the participating countries.<sup>13</sup> We operationalise this indicator as the shortest road distances between major trading centres, both in the EEC and the envisaged EEU (see Table 2).

Table 2. Comparison of the distances between major economic centres in the EEC and the EAEU

Trade flows	Distance, km
EEC	
Paris – Frankfurt	573
Frankfurt – Amsterdam	438
EEU	
Moscow – Minsk	717
Moscow – Astana	2,700

Given the distances between major economic centres, the transportation costs appear to be much higher in the case of trade within the CU than within the EEC. Besides, there is significant asymmetry in the distance between Russia's and Belarus' economic centres and those of Russia and Kazakhstan, which affects intra-bloc trade flows. This factor might significantly impede the envisaged positive effects of removing tariff barriers to trade and increasing labour mobility, and will therefore require greater efforts to ease cross-border trade, such as improving transport infrastructure.

### 3.1.3 Rates of transaction

Analysis of export structures helps us to understand whether the economies of the three member states exhibited a sufficient level of integration *prior to* the launch of the CU.

As our analysis of trade data shows, most export volumes of the CU member states are shipped to third countries, not to each other. **Russia**, as the core economy of the Customs Union had lower rates of transactions with other CU members than those recorded between the founding states of the European Economic Community. For instance, the share of exports to the CIS in the total exports of goods from Russia did not exceed 16% in the run-up to the formation of the CU, as the data in Table 3 suggest.

Table 3. Structure of Russia's exports in 2006-2010

Export, bln USD	2006	2007	2008	2009	2010
Total	303.6	354.4	471.6	303.4	400.4
to CIS countries	43.4	53.8	71.1	48.1	62.6
to non-CIS countries	260.2	300.6	400.5	255.2	337.8
Share of CIS	14%	15%	15%	16%	16%

Sources: Russian State Statistical Service; the Central Bank of the Russian Federation.

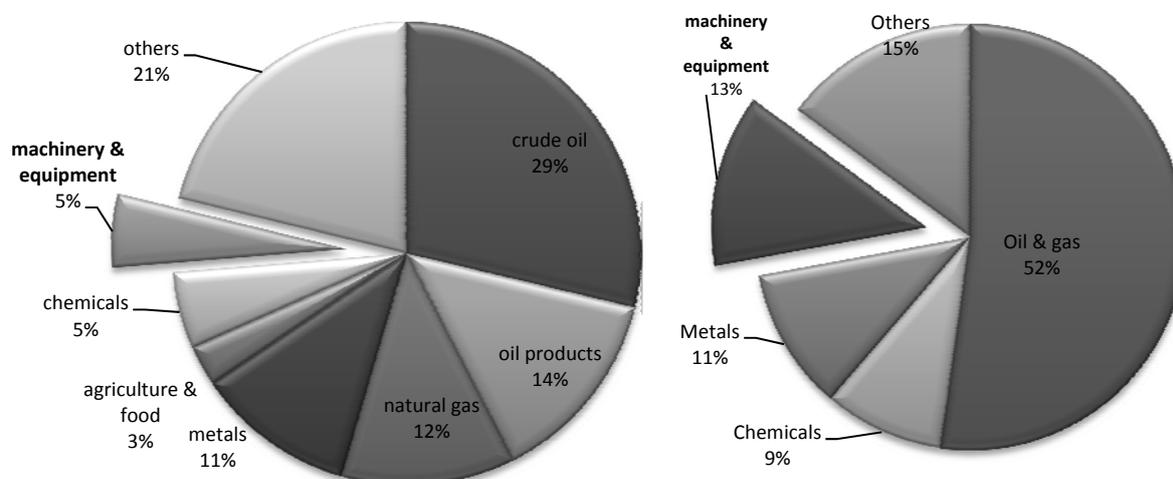
<sup>13</sup> See, for instance, Molle (1990), Frankel (1997).

Given the export structure by country provided in Table 3, Russia has been more reliant on foreign trade with third countries than with potential members of the CU, with the neighbouring CIS countries accounting for only 14-16% of total exports in 2006-2009. By comparison, the share of West German exports to other EEC-to-be members was 29.4% in 1956,<sup>14</sup> with the open economies of Belgium and the Netherlands even more dependent on intra-regional trade. Russia, as the core of the Customs Union, was therefore *ex ante* less integrated with its neighbours than the core countries of the EEC.

Another major obstacle to further economic integration within the Eurasian grouping is the openness of its members' economies to foreign trade. For instance, out of 125 countries listed, Russia was ranked as the 114<sup>th</sup> economy in the World Economic Forum's 2010 Enabling Trade Index,<sup>15</sup> while Kazakhstan's higher ranking of 88 is still a far cry from the level of openness exhibited by the West European economies participating in regional integration schemes. If the envisaged EEU is to encompass other member states, then its predecessor's current three members will need to improve their openness to trade.

Further, it is necessary to take account of trade structures to understand the economic rationale behind the establishment of the CU. Russia's trade structure is heavily reliant on the export of crude oil and oil products, natural gas and metals (see Figure 1), with manufactured products accounting for less than a quarter of *total* exports. However, the export share of the latter products was higher in trade with CIS countries, with machinery accounting for about 13%. We can thus assume that the need to increase the share of manufactured products in exports to diversify Russia's economy was part of Moscow's calculus to establish a Customs Union with Belarus and Kazakhstan.

Figure 1. Trade structure of Russia's total exports (left) and exports to CIS countries (right), 2009



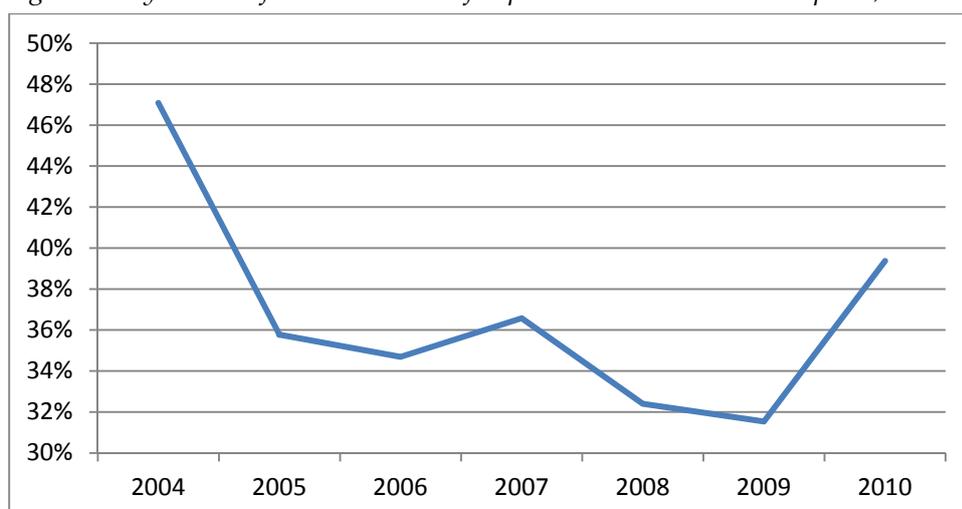
Sources: Russia's Statistical Yearbook, Russian Federal Statistics Service, 2010; author's calculations and graphics.

The trade statistics of the other two states illustrate different patterns in intra-union trade. For instance, **Belarus** was heavily reliant on trade with Russia in the run-up to the creation of the Customs Union: its exports of goods to Russia have ranged from between one-third and a half of its total trade volumes from 2004 to 2010 (see Figure 2). Therefore, Belarus had already exhibited a high intensity of transaction rates with Russia as its major trade partner.

<sup>14</sup> Data taken from OEEC Statistical Bulletin, Series IV, 1956.

<sup>15</sup> Source: The Global Enabling Trade Report 2010. World Economic Forum (2010) ([http://www3.weforum.org/docs/WEF\\_GlobalEnablingTrade\\_Report\\_2010.pdf](http://www3.weforum.org/docs/WEF_GlobalEnablingTrade_Report_2010.pdf)).

Figure 2. Dynamics of Belarus' share of exports to Russia in total exports, 2004-2010



Source: National Statistical Committee of the Republic of Belarus (2012); authors' calculations and graphics.

**Kazakhstan**, however, demonstrated a different trade structure from those of Russia and Belarus. Kazakhstan appears to be more reliant on importing from Russia: the latter accounted for only 9% of its exports and for 45% of its imports at the time of establishing the CU. Trade flows between Belarus and Kazakhstan are rather weak: for instance, Astana imported only 1.5% of its total goods from Belarus in 2009, while its exports to Belarus were virtually non-existent.<sup>16</sup>

The trends and figures above illustrate that the mutual trade in the CU was mainly aggregated by Russia, which had rather intense trade links with the two other members of the economic union, whereas Belarus and Kazakhstan had very limited trade flows in goods between them. The policies of the future EEU will have to account for this discrepancy.

Given its declared objectives, the movement of other production factors will also be an important challenge for the EEU. The imbalances in the **movement of capital** prior to the establishment of the Customs Union were highlighted by Russia's structure of foreign direct investments. For instance, Belarus accounted for about 41% of accumulated direct investment from Russia to CIS countries, while Kazakhstan only received 4.3% of the total.<sup>17</sup> **Labour mobility** is rather low between Russia and the other two member states, despite commonalities in culture and proficiency in Russian: for instance, only 5,500 people migrated from Belarus to Russia; about 2% of total influx of migrants in 2009, while Kazakh migrants (38,800 persons) accounted for 14% of the total influx.<sup>18</sup> These figures, however, are quite comparable with low inter-state mobility at the early stages of the EEC's formation, except for West Germany, which saw the influx of labour migrants from Italy in the post-war period (Fassmann and Munz, 1992); a trend that can be explained by structural factors. Russia, whose labour market is in need of qualified workers, faces tough competition from Western developed countries.<sup>19</sup>

<sup>16</sup> According to the official Kazakh statistics retrieved from (<http://www.stat.kz>).

<sup>17</sup> Russia Federal Statistics Service ([http://www.gks.ru/bgd/regl/b10\\_13/IssWWW.exe/Stg/d5/23-25.htm](http://www.gks.ru/bgd/regl/b10_13/IssWWW.exe/Stg/d5/23-25.htm)).

<sup>18</sup> Data retrieved from Demographic Yearbook of Russia (2010) ([http://www.gks.ru/doc\\_2010/demo.pdf](http://www.gks.ru/doc_2010/demo.pdf), p. 443).

<sup>19</sup> Released on 8 October 2012 (<http://www.worldbank.org/ru/news/2012/10/08/russian-economic-report-28>).

The analysis of transaction rates between the prospective members of the EEU shows a very imbalanced pattern of regional trade integration. On the one hand, Belarus is heavily dependent on exports to Russia, with a marginal share of trade with Kazakhstan. On the other hand, Russia, and especially Kazakhstan, maintained a relatively low share of exported goods to other CU members. Coupled with rather slow dynamics for the movement of capital and labour force, these starting-points make the creation of a fully-fledged economic union within the Eurasian integration process more challenging than the one undertaken by the EEC countries, especially in view of the great ambition exhibited in the short timeframes foreseen for the creation of the Eurasian Economic Union.

Overall, the relative size of the units composing the union and the distance between their economic centres present trickier background conditions for Eurasian economic integration than those shaping the European experience. The lower transaction rates (trade in goods) between member states are somewhat mitigated by the complementary trade structures.

## 3.2 Formation conditions

### 3.2.1 Implementation of common policies

The history of European integration is a testament to the importance of convergence of member states' interests at different stages of integration. This convergence will be even more salient for the Eurasian integration process, because so far it has been more reliant on initiatives and agreements between heads of state. The convergence of preferences in key policy areas (such as trade regulation) will therefore be a crucial factor in the progress of Eurasian economic integration.

The estimates concerning the degree of economic integration attained so far differ greatly. On the one hand, Eurasian Economic Commission representatives claim that the CU has now reached a stage comparable to that of the EU in 1993.<sup>20</sup> An official from the European Commission, however, opined that the current integration grouping represents only a "partial Customs Union".<sup>21</sup> In order to cut to the chase of the integration level, it is important to analyse recent developments against the proclaimed policy goals. Since the Treaty on Eurasian Economic Union (to be signed by 2015) is supposed to codify the existing provisions on the Customs Union and the Common Economic Space (according to Article 34 of the Treaty on Eurasian Economic Commission), we base our analysis of the implementation of common policies on the goals stated in the treaties.

The goals of the CU were determined in Article 2 of the *2007 Treaty on the Establishment of Customs Union* as follows:

- a) The common customs tariff and other measures regulating international trade with the third countries are defined and applied;
- b) The unified trade regime is established and applied in trade with the third countries;
- c) The procedure for charging and distributing customs duties and other dues, taxes and fees of equivalent effect is set and applied;
- d) The unified rules for determining the country of origin of goods are set and applied;

<sup>20</sup> Tatyana Valovaya, Member of the Board of the Eurasian Economic Commission and Minister in charge of the development of integration and macroeconomics, in her speech at a CEPS event devoted to a discussion of the findings of this study, Brussels, 3 December 2012.

<sup>21</sup> Peter Balas, Deputy Director General, DG Trade, in his speech at the same CEPS event.

- e) The unified rules for determining the customs value of goods are set and applied;
- f) The unified methodology for statistics of external and mutual trade is developed and applied;
- g) The unified order for customs regulation, including the unified rules for declaring goods and paying customs duties and the common customs regimes is set and applied;
- h) The bodies of the customs union are established and operate within the limits of their competence as authorised by the Parties.”

These goals boil down to the two most important priorities: elimination of intra-bloc tariffs, establishing a common external tariff policy and the elimination of non-tariff barriers. There has been substantial progress in implementing the first two goals over the past five years; however, with several gaps remaining.

### 3.2.1.1 *Elimination of intra-bloc tariffs*

Within two years, the CU member states have accomplished the bulk of their primary tasks. First of all, quantitative restrictions have been eliminated within the Customs Union, thus mirroring the developments in the EEC in the 1960s.

Secondly, the import duties between the CU member states were removed in 2010. This development is similar to the EEC practice: Article 13 of the Rome Treaty provided for a “progressive” abolishment of import duties between EEC member states. Customs duties between member states were eliminated by 1 July 1968. Formally speaking, it took the Customs Union of Eurasian Economic Community two years to attain the economic integration level that took the EEC a decade to achieve. However, such quantitative restrictions and intra-bloc tariffs are not the most stringent obstacles to trade, as the dynamics of intra-bloc trade are impeded by the proliferation of non-tariff barriers (NTBs) to mutual trade.

A stumbling block in the formation of the CES was the controversy over oil export duties. Contrary to Belarus’ claim in 2010 that the export duties on Russian oil and oil products should be eliminated within the Customs Union, Russia’s then Prime Minister Putin insisted that the duty could only be abolished after Belarus’ accession to the Common Economic Space (Yafimava, 2010). Export duties for Belarus were slashed in the intra-bloc trade in 2012.<sup>22</sup> In exchange Belarus yielded the right to levy the duties on oil exported from the territory of the Customs Union, thus favouring Russian exports.

### 3.2.1.2 *Common tariff policy*

The common external tariff (CET) was established in January 2010 as a major element of common tariff policy of the Customs Union. The CET is a set of customs tariff rates applied to imports from third countries into the common customs territory of Russia, Belarus and Kazakhstan. In this regard, the CU has mirrored the achievements of the common tariff policy of the European Economic Community, as set out in Article 9 of the Rome Treaty establishing a “common customs tariff in their relations with the third countries” and implemented by 1 July 1968.

The introduction of CET partially affected the tariff rates in Russia, Belarus and Kazakhstan. Most tariff lines in the member states remained unchanged, as Russia and Belarus already

<sup>22</sup> In particular, the export duty rates are quoted as “export duty rates for oil and some oil products exported from customs territory of Russia and other Customs Union members” in the Russian Government Decree of 22 September 2012, source: (<http://www.rg.ru/2012/09/25/neft-dok.html>).

had similar tariffs for about 70% of tariff lines. Apart from that, Kazakhstan had to increase its tariff rates for over 20% of tariff lines, while Russia and Belarus were bound to decrease tariff rates for about 25% of the tariff lines (EBRD, 2012). However, the formal introduction of the common external tariff (CET) coexists with exceptions in each member state,<sup>23</sup> which are to be eliminated by 2015.

Thus, the major challenges that the formation of the Eurasian Economic Union is currently facing are two-fold. On the one hand, it has yet to complete the formation of the Customs Union by eliminating existing exemptions for CET and harmonising tariffs. On the other hand, it has to coordinate these 'tariff innovations' with the commitments that Russia undertook as part of its accession to the World Trade Organization, which are bound to become a part of EEU legislation, according to the Treaties (see Box 1, below). In order to implement some of these commitments, the Commission revised the common external tariff for about 10% of product lines in August 2012,<sup>24</sup> which entailed decreased import duties for cars, textile and food products, however, with little impact on duties for most manufactured goods.

A number of other issues emerged in the process of establishing new tariff rates. For instance, in 2011 the Federal Customs Service filed a proposal<sup>25</sup> to increase the duties for high-tech computer products to 10%, despite the fact that most such products are not produced in the domestic market. Such regulatory trends illustrate a tendency to 'isolate' the CU market from the global economy, which could harm local consumers in the CU countries.

### 3.2.1.3 *Eliminating non-tariff barriers*

The transition to the Common Economic Space poses the challenge of eliminating non-tariff barriers (NTBs) to intra-bloc trade. The most crucial NTBs in the CES are inefficient customs procedures, poor infrastructure, inadequate institutions and regulations (EBRD, 2012).

Research in the EU suggests that completion of the EU internal market in the early 1990s, which included the elimination of NTBs, had rather favourable effects on the EU's external trade: it led to a significant increase in EU/EFTA trade in goods and produced welfare gains (Molle, 2000); effects on trade with developing countries were positive rather than negative (Koekkoek, 1990). Likewise, if more tangible benefits are to be expected from Eurasian integration, its member states have to vigorously pursue the elimination of non-tariff barriers, either through national legislation or through legally-binding decisions of the competent supranational institutions.

*(continued on page 13)*

<sup>23</sup> For instance, Kazakhstan was permitted to retain different tariffs for a range of tariff lines during the transition period, mainly railway transport, pharmaceuticals and medical equipment, plastic and rubber. More information about the exemptions is available on the website of Eurasian Economic Commission (<http://www.tsouz.ru/db/ettr/Pages/Perehodny2012.aspx>) (Russian).

<sup>24</sup> *Kommersant*, 23 August 2012 (<http://www.kommersant.ru/doc/2006988/print>) (Russian).

<sup>25</sup> Source: *Kommersant Daily*, 16 August 2011 (<http://www.kommersant.ru/doc/1752689/print>) (Russian).

*Box 1. Russia's WTO commitments impacting on the CU and CES policies*

The *Treaty on the Functioning of the Customs Union in the framework of the Multilateral Trading System* establishes the guidelines for compliance of the Customs Union legislation with WTO commitments. According to Article 1.1 of the Treaty, the commitments undertaken during any member state's accession to the WTO become part of the Customs Union legislation, but the Party has to notify other Customs Union members of these provisions and coordinate the actions necessary for accession. The commitments undertaken by Russia will therefore become the integral part of the Eurasian Economic Union legislation. According to the *WTO Accession Protocol*, Russia's commitments include:

- 1) Gradual import tariff cuts for trade in goods: one-third of national tariff lines at the date of accession, one-quarter - within 3 years, the rest - within the next 7 years (cars and planes);
- 2) Gradual liberalisation of trade in services: elimination of foreign equity limitation for telecoms (4 years after accession), access for foreign insurance companies (9 yrs), no equity cap for subsidiaries of foreign banks;
- 3) Export duties on mineral fuels and oils to be "fixed";
- 4) Enhancing market access (by limiting non-tariff barriers):
  - o elimination of quantitative restrictions on imports;
  - o "equalisation" of railway transportation charges for exporters;
  - o implementation of WTO rules into Russian laws and regulations for transit of goods.
- 5) Obligation to join the *WTO Government Procurement Agreement (GPA)* within 4 years;
- 6) All industrial subsidies to be eliminated and agricultural subsidies restricted;
- 7) Producers and distributors of natural gas in Russia are to operate on "normal commercial considerations", but regulation of prices for households is permitted;
- 8) Technical barriers to trade (TBT):
  - o Russian legislation to comply with *WTO TBT Agreement*;
  - o Sanitary and Phytosanitary (SPS) measures can be applied in the Customs Union only according to the WTO agreement;
  - o Veterinary export certificates, different from CU standards, can be negotiated with exporters to Russia, if they request so;
  - o Application of "international standards" for technical regulations;
  - o Telecom equipment: regulations to be limited but consistent with CU and Eurasian Economic Community (EurAsEC) agreements;
  - o List of products with obligatory certification in CU to be limited according to *WTO TBT Agreement*.
- 9) Trade-related Investment Measures (TRIMs):
  - o Implementation of *WTO Agreement on TRIMs* into Russian legislation;
  - o Exception made for the existing automotive investment programs till 2018.
- 10) Trade-related Intellectual Property Rights:
  - o *WTO Agreement on TRIPR* to be fully applied, with no transitional period;
  - o *Berne Convention for Protection of Literary and Artistic Works* to be applied.
- 11) Annual reporting on Russia's privatisation programme to the WTO;
- 12) State price controls (on natural gas, gas transportation etc) to be published in media;
- 13) Changes on Customs Union legislation have to be announced to the WTO prior to adoption, so that they could be commented upon to the "competent Customs Union body".

Source: World Trade Organisation (WTO), 10 November 2011.

The experience of the European Economic Community illustrates that there are three major avenues of eliminating NTBs:

- 1) regulatory competences of the European Commission since EEC creation. According to Article 10 of the Rome Treaty, the Commission obtained a right to “determine the methods of administrative co-operation [...], taking into account the need to reduce as much as possible formalities imposed on trade”, with a particular time constraint imposed on the implementation of the co-operation mechanism: “before the end of the first year after the entry into force of this Treaty”.
- 2) specific rulings of the European Court of Justice (ECJ) in the 1960-1970s;
- 3) measures proposed in the Single European Act (1986).

Since all these mechanisms put particular emphasis on the competences of supranational institutions in the elimination of NTBs to create a genuinely single market, we shall discuss their role in the Eurasian context in the next chapter.

### 3.2.2 Supranational institutions

In order to draw conclusions on the scope of further integration within the envisaged Eurasian Economic Union, we shall compare the competences of the supranational bodies (the Commission and the Court) in regulating the intra-bloc trade in goods in the CU/CES with those exerted by similar institutions in the EEC in 1960-1980s.

#### 3.2.2.1 The Eurasian Economic Commission

According to Article 1 of the 2011 Treaty, the Eurasian Economic Commission is a “regulating body” ensuring the functioning and development of the Customs Union and the Common Economic Space. This broad statement does not, however, disclose the Commission’s exact competences in major policy areas, let alone delineate the inter-institutional boundaries. For this reason, it is necessary to analyse the Commission’s functions and competences as stipulated by the Treaties in more detail.

##### Functions

According to Articles 6, 8 and 18 of the 2011 Treaty, the functional capacities of the Eurasian Economic Commission within the integration framework are much more limited than those enjoyed by the European Commission (set out in the Section 3 of Treaty of Rome).

Table 4. Comparison of the functions of the Eurasian Commission and the European Commission

Functions	European Commission (according to the Treaty of Rome)	Eurasian Economic Commission (according to the 2011 Treaty)
Legislative	<ul style="list-style-type: none"> <li>• Adopt regulations, issue directives, take decisions, make recommendations or deliver opinions – shared with the Council (Art. 189)</li> </ul>	<ul style="list-style-type: none"> <li>• Right to generate “proposals for economic integration” within CU &amp; CES (Art. 1) and adopt CU technical regulations (directly applicable in the legal orders of the member states), decisions &amp; recommendations (Art. 18)</li> </ul>
Executive	<ul style="list-style-type: none"> <li>• Monitor the application of legislation (Art. 155), in particular by using the infringement procedure before the Court (Art. 170)</li> </ul>	<ul style="list-style-type: none"> <li>• Monitor implementation of legislation (Arts. 9, 18) and discretionary power to refer violations to the Court (Art. 20)</li> </ul>

Budgetary	<ul style="list-style-type: none"> <li>• Consolidate a preliminary “draft budget” (revenues &amp; expenses); to submit to Council (Art. 203)</li> <li>• Implements the budget (Art. 205)</li> </ul>	<ul style="list-style-type: none"> <li>• Designs and plans its <i>own</i> budget only (Art. 9 and 18)</li> </ul>
Representative	<ul style="list-style-type: none"> <li>• External representation</li> <li>• Negotiate trade agreements with third states in line with Council mandate (Art. 113(3))</li> </ul>	<ul style="list-style-type: none"> <li>• Manage representations in member states and third countries (Art. 18)</li> </ul>

This comparison of the functions attributed to the two Commissions allows us to make several conclusions about the institutional capacity of the Eurasian Economic Commission. First, the role of the Eurasian Economic Commission is clearly skewed towards the ‘executive’ functions. On the one hand, its legally binding decisions enable it to create new (secondary) legislation; on the other hand, it is constrained by the Interstate Council’s decisions and existing legislation (Art. 3).

Secondly, the executive role of the Eurasian Commission is rather diluted compared to its European prototype. According to Article 6 of the 2011 Treaty, the Eurasian Economic Commission is indeed responsible for implementing and monitoring compliance of the “international treaties that form the legal basis of the Customs Union and the Common Economic Space”, thus endowing it with an executive role. However, the actual mechanisms for such implementation and monitoring are rather weak, as discussed later in this section.

In terms of its budgetary role, the powers of the Eurasian Economic Commission differ significantly from those attributed to the European Commission. On the one hand, the Eurasian Economic Commission has adopted a similar mechanism of forming its ‘own resources’ to that pioneered by the European Economic Community. Specifically, Article 7(3) of the Treaty establishes the sources of the Commission’s budget as the member states’ contributions proportional to the distribution of collected import duties. However, the powers of expenditure vested in the Commission have been curtailed: it can only outline the project of its own budget and implement it if approved by the Supreme Eurasian Economic Council. Interestingly though, the Treaty does not explicitly limit the Commission’s expenditure, and the very procedure of negotiating the volume of the budget by the Eurasian Economic Commission remains unclear.

Last but not least, the representative functions of the Eurasian Economic Commission in trade policy are not strong enough to negotiate agreements with the third countries on behalf of the Customs Union. For instance, the Treaty points out that the Eurasian Economic Commission *may* be granted<sup>26</sup> a right to sign international treaties within the scope of its competences; thus partially mirroring the European Commission’s mandate in external trade relations, but in a rather ‘trimmed’ fashion.

#### *Competences in major policy areas*

According to Article 3 of the Treaty on the Eurasian Economic Commission, the Commission operates within the areas of customs tariff and non-tariff regulation, as well as competition policy; areas in which the European Commission enjoys exclusive competence. However, the Eurasian Economic Commission has also been granted competence in a range of policy areas where the European Commission enjoys only shared competence, such as energy policy and transport. Besides, the Eurasian Economic Commission’s competences in macroeconomic

<sup>26</sup> By the Supreme Eurasian Economic Council.

policy and regulation of state monopolies appear particularly ambitious at this stage of economic integration.

Conversely, the exercise of competences is significantly limited by the fact that the institutional architecture of the Eurasian Economic Union is in *statu nascendi*. Besides, some caveats contained in the 2011 Treaty may inhibit the Commission's regulatory activity in key policy areas: competition and regulation of state monopolies. According to Article 6 of the Treaty, the Eurasian Economic Commission can request the authorities of member states to provide "information, necessary for carrying out its functions", except for the "classified" information and data with "restricted dissemination" according to the law of a member state. It is unclear, however, how this caveat will be applied in practice. If the Eurasian Economic Commission, in pursuing its competition policy mandate, needs to request any information about Russian state-owned "strategic enterprises" it might be refused such data without the prior consent of Russian authorities, according to the Presidential Decree "On measures to defend the interests of Russian Federation in the foreign economic activity of Russian business entities" as of 11 September 2012.<sup>27</sup> Such conflicts of regulatory competence should be resolved in order to secure the efficient operation of the Eurasian Economic Commission within its mandate defined by the 2011 Treaty.

#### *Structure*

The structure of the Eurasian Commission's Board is characterised by a longer chain of command than that of the European Commission. According to the 2011 Treaty, the Chairman of the Commission Board is tasked with organising the activity of the Board and liaising with the Commission's Council and the Supreme Council (Article 23), while members of the Board "coordinate and control" the activities of their Departments (Article 24). Thus, the Treaty effectively creates a 'two-tier' system cross-cutting the major policy areas: such as macroeconomic and competition policy.

The *Departments* are chaired by Directors (Article 27) in a management structure similar to Directorates-General (DGs) in the European Commission, yet with a very different distribution of competences according to major policy areas: for instance, only the departments of Agriculture Policy, Competition Policy, Energy, Internal Market and Statistics have their 'counterparts' in the European Commission (DGs: AGRI, COMP, ENER, MARKT and Eurostat accordingly). Many departments reflect the current agenda of economic integration: for instance, the Department of Sanitary and Phytosanitary Measures and the Department of Customs Legislation and Implementation.

#### *Decision-making*

The 2011 Treaty lays the foundations for the decision-making mechanism in the Eurasian Economic Commission. The approach taken in regard to the Commission's Council mirrors the 'one member state - one commissioner' rule of the EEC: Article 7 of the 2011 Treaty posits that every member of the Commission's Council and the Commission's Board has one vote; while Article 12 establishes that the decisions in the Commission's Council are passed as a consensus. The Commission's Board - as an 'executive body' of the Commission - (according to Article 14) includes three representatives from member states acting in an independent capacity (Article 15), each of whom is in charge of a particular department within the Commission. Board decisions can either be made unanimously or with a qualified majority vote, depending on the issues (Article 21). This hierarchical two-tier system with mixed decision-making procedures within the Commission is a clear break from the

<sup>27</sup> Retrieved from (<http://www.kremlin.ru/acts/16463>) (Russian). See Riley (2012).

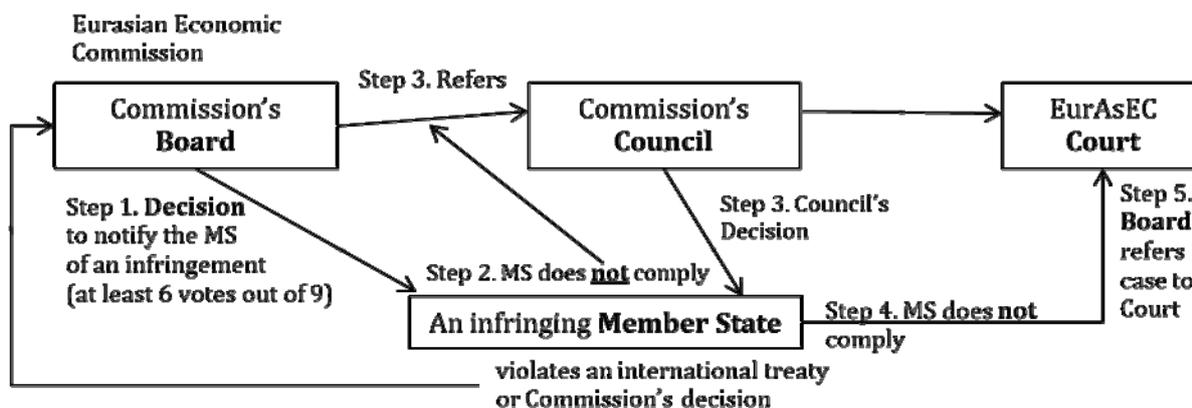
European Commission precedent, and might significantly complicate the decision-making process in those policy areas that require independent and pro-active operation by the Eurasian Economic Commission, most notably non-tariff regulation and competition policy.

The distribution of functions between the two Eurasian Economic Commission bodies remains rather vague in the 2011 Treaty: while the Commission's Council is in charge of "general regulation of integration processes" in the CU and the CES (according to Article 8), the Commission's Board is supposed to carry out implementation and monitoring compliance (Article 18) of the main policies. Further delineation of the functions in particular policy areas appears crucial for the efficiency of implementing essential policy objectives that pertain to the creation of an economic union.

### *Monitoring compliance*

One of the most effective mechanisms of enforcing supranational regulation in the EEC has been for the European Commission to initiate proceedings for alleged breach of Community law. A similar procedure within the Eurasian Economic Community is set out in Article 20 of the Treaty: if a member state violates Treaty provisions or a Commission decision, then the Commission's Board can make a decision (with two-thirds of the votes, currently requiring at least two member states) to "notify" the member state in question of the need to eliminate the violation within a "reasonable" period of time; if the latter fails to do so, the Board refers the issue to the Commission's Council. Only if the member state ignores the Council's decision can the Board refer the case to the EurAsEC Court (while notifying the Commission's Council and the Supreme Council). The infringement procedure is further depicted in Figure 3 below.

Figure 3. The infringement procedure initiated by the Eurasian Economic Commission



Source: Provisions of the 2011 Treaty; authors' graphics.

In comparison to the EEC practice, member states in the CES effectively preserve more control over the infringement procedure, which could potentially decrease credible incentives to comply with the (legally binding) decisions of the Eurasian Economic Commission. Moreover, the question of possible penalties applied by the EurAsEC Court on member states that are found to be in breach also remains open in the Eurasian model of law enforcement.

By way of conclusion, the competences and decision-making procedures of the Eurasian Economic Commission appear to be narrower than those seen in the European Commission. Firstly, its two-tier chain of command might significantly complicate and prolong the decision-making process. Secondly, its effective functions within the institutional integration

process are likely to be limited to monitoring and consulting, due to the apparent weakness of infringement procedures.

### 3.2.2.2 *The Court of Eurasian Economic Community*

#### *Jurisdiction*

According to Art. 13(2) of the EurAsEC Court's Statute (5 July 2010), the Court rules on disputes of an **"economic nature"** that arise between Parties regarding the implementation of decisions of the EurAsEC institutions and treaty provisions in effect within the EurAsEC". The Court **interprets the treaty** provisions when a) issuing rulings on specific cases; b) when receiving requests for clarification from Parties (Member States), "Higher courts of the Member States", the Intergovernmental Council, the Parliamentary Assembly of EurAsEC, or the EurAsEC Integration Committee (Art. 13 (3) of the Court Statute). The latter resembles the preliminary rulings procedure before the European Court of Justice. According to Article 3(1) of the *Treaty on Application to the EurAsEC Court of the Economic Entities regarding disputes in the Customs Union*, the "Higher Courts" of the member states can file a "request" with the Court to issue a "conclusion" on "applying international treaties of the Customs Union" and "acts of the Commission which affect the rights and interests of economic entities", if these questions "significantly affect the resolution of the case".

According to Art. 13 (4) of the Statute, the Court rules on disputes in 3 cases: between the Commission and member states (infringement procedures and actions for failure to act), in inter-state complaints, and "in other cases" mentioned in the treaties (see below). Pursuant to Article 2 of the *Treaty on Application to the EurAsEC Court of the Economic Entities regarding disputes in the Customs Union*, the Court hears cases on the Commission's "acts" or their specific provisions (see the "Yuzhny Kuzbass vs The Commission" case mentioned below) and on disputed "actions" or "inaction" of the Commission.

The "economic entities" that can file an application with the Court are listed in Article 1 of the Treaty: natural persons, but only if s/he is registered as an entrepreneur in one of the member states, and legal persons. The *locus standi* before the EurAsEC Court is thus more limited than before the European Court of Justice, where an open-ended group of natural persons can initiate proceedings, if only they can show that they are directly and individually concerned by acts adopted by the institutions. According to Article 14(2) of the Court's Statute, only member states, official bodies of member states and business entities have standing before the EurAsEC Court.

#### *Case study*

The Court's jurisdiction in intra-bloc disputes can be illustrated by its judgment of 5 September 2012 in a suit filed by the public joint-stock company "Yuzhny Kuzbass", a major coal supplier owned by *Mechel Group*, a vertically-integrated metallurgical company, against an act adopted by the Eurasian Economic Commission. The applicant disputed the provision of Article 1 of Commission Decision No. 335 "On issues pertaining to the functioning of the common customs territory and implementation of Customs Union mechanisms" (17 August 2010), which stipulated a customs declaration for Group 27 goods exported from Russia (including coal). Following the 2011 decision of the Intergovernmental Council abolishing customs clearance of goods supplied between member states within the Customs Union since 1 July 2011, the company had stopped declaring its shipments of coal, but was fined by the *Kemerovo Customs Administration* (Russia). After having incurred financial losses, the company brought the case before the EurAsEC Court to resolve this conflict of norms.

The EurAsEC Court ruled in favour of the applicant and declared the provision of Article 1 “incompliant” with CU legislation, based on the following arguments:

- the Commission’s decisions are part of CU legislation;
- the Commission can make non-binding “recommendations”, as well as binding decisions;
- the Commission’s decisions cannot contain vague and ambiguous formulations of a “declaratory or informative” nature;
- The provision of Article 1 of Commission Decision no. 335 “contradicts” the legal base, namely the 2007 Treaty creating the CU and the Customs Code, as well as “goals and principles” of establishing the CU and CES, including non-discrimination of Parties.

Hence, the EurAsEC Court issued a ruling that repealed part of the Commission’s decision conforming to Russian law, thus (indirectly) prescribing the national authorities to apply the CU law over conflicting national rules. The Appeal Chamber upheld the Court’s ruling on 29 November 2012, thus confirming the principle of primacy of CU/CES law over conflicting national law and relieving business entities (such as the *Mechel* Group) of the need to go through a cumbersome procedure of customs declaration. The Court thereby effectively eliminated one of the non-tariff barriers to intra-bloc trade.

#### *Principles of Direct Effect and Supremacy*

The ruling of the EurAsEC Court in the *Yuzhny Kuzbass*-case bears similarities to the groundbreaking judgments of the European Court of Justice in case 26/62 *Van Gend & Loos vs. Netherlands Internal Revenue Administration* (finding that Article 12 of the EEC Treaty “produces direct effects and creates individual rights which national courts must protect”)<sup>28</sup> and in case 6/64 *Costa vs. ENEL* (in which it established the principle of “supremacy” of Community law over conflicting national law of a member state).<sup>29</sup> As such, the ECJ was instrumental in creating an autonomous legal order for the EEC, supreme to the national law of the member states and characterised by the potential for vigilant individuals to invoke its rights and obligations directly before a national judge. The EurAsEC Court in Minsk could play a similar role in consolidating the Eurasian economic integration process, provided that the implementation of its rulings are not impeded by national authorities in the member states. It therefore remains to be seen whether the Russian authorities will indeed take the necessary measures to comply with the EurAsEC Court’s first landmark judgment.

#### *Dispute resolution between member states*

Another important issue is the role of the Court in resolving disputes between the member states. Although rather rarely, the European Court of Justice has seen cases brought by member states against other member states. To compare, the EurAsEC Court has a secondary role in resolving inter-state disputes. According to Article 34 of the 2011 Treaty on the Eurasian Economic Commission, such disputes regarding the interpretation and implementation of the Treaty are resolved first through “consultations and negotiations between the Parties involved”. The case can be referred to the Court only if consensus has not been reached within six months. This caveat might therefore significantly slow down the dispute-resolution process, should a particularly contentious yet urgent issue arise.

<sup>28</sup> Judgment of the Court, Case 26/62, *Van Gend & Loos*, ECR 1963, p. 1.

<sup>29</sup> Judgment of the Court, Case 6/64, *Costa v. ENEL*, ECR 1964, p. 585.

To conclude, the EurAsEC Court has the potential to eliminate non-tariff barriers within the Customs Union by ruling in the crucial cases that reveal conflicts between CU law and national laws. Given that the incorporation of EEU law is likely to linger until 2015, the Court decisions might plug the legal gaps that pose evident obstacles to trade agents in the member states.

### 3.3 Process conditions

Estimates of the effects of the CU on the member states' economies and political systems made in the academic and policy-oriented literature have differed markedly so far. On the one hand, CIS-based economists forecast an additional 2.5% growth to aggregate GDP for the members of the CU and the CES by 2030 (Ivanter et al., 2012). Other analysts are more critical about the long-term effects of the Customs Union. According to Vinhas de Souza (2011), the EurAsEC Customs Union is a GDP-reducing framework, "wherein the negative trade-diversion effects clearly overwhelm any positive trade-creation effects" and therefore the external trade positions of all member states worsen. After having analysed three possible integration scenarios, de Souza claims that these adverse effects can be mitigated only by full harmonisation of the energy sectors of the participating countries. Furthermore, Anders Aslund points out<sup>30</sup> that the "Eurasian Union" is unlikely to bring about economic and political integration and will lead to "Russia's isolation with Belarus and Kazakhstan at great cost to the Kremlin".

Given these differing assessments of the political and macroeconomic effects of the Eurasian integration process, it is important to take stock of both the institution-building process and the actual dynamics of the economic development within this grouping over the past three years. Therefore, in this section we analyse whether the Eurasian integration process has furthered a more integrated governance mode in the political realm and intensified economic cooperation between the member states, as initially intended by the creation of the Customs Union and the Common Economic Space.

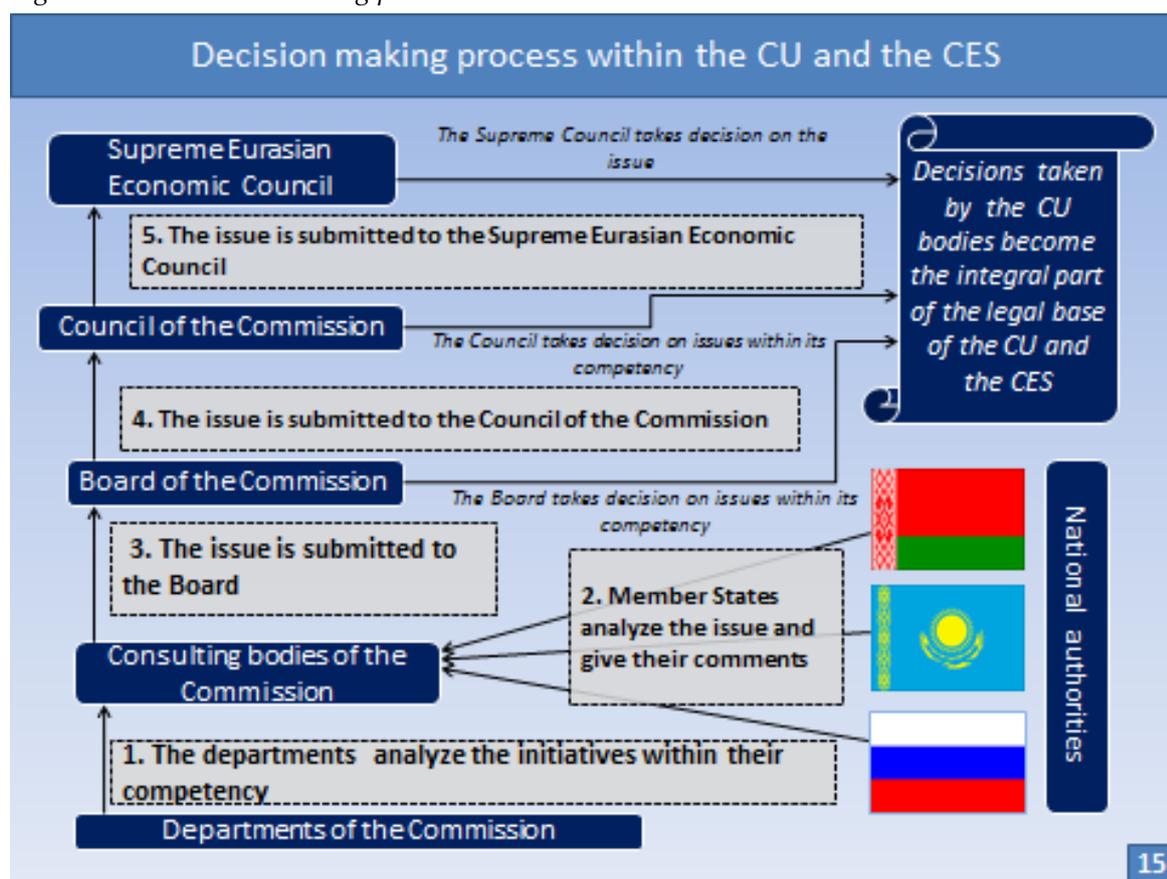
#### 3.3.1 Decision-making mode

Having analysed the role of the nascent supranational bodies of the Customs Union and Common Economic Space in the previous section, we uncovered a number of pitfalls for the efficiency of their functioning. Arguably, unlike the early years of European economic integration, which was spurred by the neo-functional extension of the supranational institutions' competences to new policy areas, Eurasian integration is mainly based on and guided by the intergovernmental mode of governance.

Despite the establishment of the supranational Eurasian Economic Commission, the decision-making process within the CU and the CES leans towards the intergovernmental model with the member states' governments holding substantial decision-making powers. This is in contrast to the EEC, which had stronger supranational characteristics. The member states of the CU and the CES participate in the work of the Eurasian Economic Commission, both in the early stages of policy shaping through the consultative bodies of the Commission and in the decision-making process through the Supreme Eurasian Economic Council (see Figure 4, below).

<sup>30</sup> See A. Aslund (2012).

Figure 4. The decision-making process in the CU and the CES



Source: Official website of the Eurasian Economic Commission (<http://www.tsouz.ru>).

The **Supreme Eurasian Economic Council** is the highest body within the Customs Union and the Common Economic Space. In terms of structure, it comprises the heads of state or government. Importantly, it defines the strategy and the objectives of the further development of the CU and the CES, thus retaining its grip over the integration process. It also decides on the areas of the Commission's operation within the powers conferred by the CU and the CES treaties.

The Supreme Eurasian Economic Council approves the procedures that the Commission has to follow as well as the budget, staff and departments. The Council also decides on opening Commission missions in the member states, in third countries and in international organisations. The Supreme Eurasian Economic Council may grant the Commission the right to sign international treaties and agreements on matters within the competence of the Commission that are also subject to the Supreme Eurasian Economic Council's ratification. In comparison, the Council of Ministers – the main decision-making body in the EEC – had less power over the Commission than the Supreme Eurasian Economic Council has over the Eurasian Economic Commission. Overall, the decision-making rules in the EEC were more favourable for the supranational mode of governance, with the Commission exerting more treaty-based competences and policy implementation powers.

The Eurasian Economic Commission's consulting bodies are composed of seconded national experts in order to facilitate communication with the member states and participation in the work of the Commission. They are responsible for ensuring that member states' interests are taken on board by the Commission. By contrast, the consultative bodies of the High Authority had merely an advisory function and consisted of producers, interest groups and

workers. As analysed in the previous section, the ECJ had a larger mandate than the EurAsEC Court of Justice.

Table 5. Comparison of the decision-making structures in the CU/CES and the EEC

Bodies	EEC	CU and CES
Principle decision-making body	The Council of Ministers is the principle decision-making body. Decides by unanimity, qualified majority or simple majority vote.	The Supreme Eurasian Economic Council holds the right to approve the procedures, budget, staff and departments of the Commission. Decision-making mode is unanimity.
Commission	The Commission has a right of initiative, some decision-making and implementation powers. Guardian of the treaties.	The Commission has the right to make decisions and recommendations but submits proposals on the main directions of integration for the approval to the Supreme Eurasian Economic Council. Guardian of the treaties.
Consulting bodies	Consultative Committee comprising producers and interest groups with purely advisory function (e.g. ECSC Treaty, Economic and Social Committee).	Facilitates communication between the member states and the Commission to ensure that member states' priorities are reflected in the Commission's proposals.
Parliament	Assembly to provide democratic input with an advisory role (later directly elected).	No role.
Court	Ensures the proper interpretation and application of the Treaty and secondary legislation.	Ensures the proper interpretation and application of CU law. Natural persons have limited <i>locus standi</i> .

The lack of a parliamentary dimension in the Eurasian integration process can be viewed from two perspectives. As outside observers point out, its absence deprives the Eurasian economic integration process and institutions of democratic accountability, despite the fact that rules and decisions impact on consumers and businesses in member states. On the other hand, representatives of the Eurasian Economic Commission point out that this is a temporary lacuna bound to be filled in the near future, as "national parliaments are fighting for their place" in the institutional set-up of the CU and CES.<sup>31</sup> The sheer involvement of national parliaments is not likely, however, to drastically change the decision-making mode, unless they obtain blocking or co-decision powers vis-à-vis the Commission and the Supreme Council. There are signs that a consultation process is underway in the business community of the three countries. As a representative of the Russian Union of Industrialists and Entrepreneurs pointed out,<sup>32</sup> business associations of Russia, Belarus and Kazakhstan signed an agreement to launch a "Business Dialogue" in October 2010, followed by a Consultative Council linking the Commission with business representatives. This development could be compared to the establishment of the European Economic and Social Committee in 1958; however, the CU structures currently seem to lack representation of employees.

<sup>31</sup> Tatyana Valovaya's remark at the CEPS event on 3 December 2012.

<sup>32</sup> Oleg Preksin, Managing Director for International Cooperation of the Russian Union of Industrialists and Entrepreneurs, in his speech at the CEPS event on 3 December 2012.

Despite the innovations brought about by the Eurasian Economic Commission's newly acquired competences and the first EurAsEC Court ruling, the decision-making process in the Customs Union and the Common Economic Space is based on intergovernmentalism. Thus, the implementation of the key policies envisaged in the Eurasian Economic Union is likely to be carried out at the intergovernmental rather than the supranational level of governance.

### 3.3.2 *Economic effects of Eurasian integration*

As scholars of international trade (Viner, 1950; Molle, 1990) point out, the introduction of a customs union may cause trade creation and trade diversion effects. In order to evaluate such effects in the CU and CES, we analyse the dynamics and the structure of intra-union trade volumes based on the available data in the 2010-2012 time period.<sup>33</sup> This analysis is geared towards a conclusion on the level of Eurasian trade integration that has been achieved so far,<sup>34</sup> particularly in comparison with the European Economic Community developments in the comparable time period.

Before analysing the preliminary effects of Eurasian integration, it is opportune to take stock of the developments that took place in the early stages of the European integration process. According to existing research, the EEC's creation had a number of **positive effects** on the economies of the member states, yet **adverse effects** on their global economic links.

1. Trade creation: the volumes of trade between EEC member states have increased significantly over the years, facilitated by the economies of scale in the EEC intra-industry trade (Moore, 1994). This development suggests that European integration was conducive to the expansion of markets for large industrial producers inside the EEC. Notably, positive trade creation effects were most prominent in sectors such as machinery, transport and fuels, thus reflecting growing specialisation across industries.
2. Trade diversion for manufactured products: evidence suggests that a substantial share of imports from countries outside the EEC was replaced by imports from other EEC members (Balassa, 1974). This trend implies an increasing 'isolationism' of the EEC member states from external suppliers and markets, which creates obstacles to the global liberalisation of trade. Trade diversion has affected sectors such as food and chemicals.
3. Long-term economic growth: research shows that EEC members increased their growth rates by 0.6-0.8% a year (Henrekson et al., 1997), as a result of their economic integration.

These overall positive effects of early European integration could serve as a useful benchmark for evaluating the possible economic effects of Eurasian economic integration and highlighting potential benefits and pitfalls in the process.

To begin with, official sources report rather positive trends in Customs Union trade. According to the statistics published by the Eurasian Economic Commission, mutual trade volumes within the Customs Union grew on a year-on-year basis by 29% in 2010, 34.6% in

<sup>33</sup> Only the data from January to August 2012 were supplied by member states' statistical services so far; we thus present the data on a quarterly basis, i.e. for the first two quarters.

<sup>34</sup> Representatives of the Eurasian Economic Commission point out that progress of the integration grouping is illustrated by the consistent growth of intra-union trade. According to Tatyana Valovaya, volumes of intra-union trade have almost doubled since the Customs Union was established.

2011<sup>35</sup> and 13.5% in the first half of 2012,<sup>36</sup> thus underpinning a rather strong trend of intra-bloc trade increase over a 2.5 year period. However, despite the seemingly positive *general* trend, these data on total trade volumes do not allow us to discern the trade effects of the Customs Union in sectors with higher added value, such as metallurgy, machinery and equipment. For that reason, a deeper analysis of bilateral sectoral trade between the CU member states is required to make a tentative conclusion on whether the initial integration managed to encourage trade flows in the sectors most susceptible to trade liberalisation within the CU and the CES.

In order to gauge the effects of Eurasian integration in this section, we shall analyse the following outcome-based indicators:

- 1) the dynamics of intra-union trade volumes in the most important sectors, which could help highlight possible trade creation effects;
- 2) the change in the share of imports of manufactured goods by CU member states in total imports in comparison to other major trade partners, which could serve as an indicator of possible trade diversion patterns in Eurasian integration;
- 3) other effects of integration measured in terms of investment flows and migration changes.

Such an analysis presents us with two inter-related methodological challenges:

- Defining the **time limits** of the analysis. The elimination of customs borders and tariffs between CU member states, which occurred in 2010, would (in theory) serve as a strong impetus for increasing intra-bloc trade flows. However, in practice, a certain time lag would be expected in the activity of foreign trade agents.
- Accounting for the **exogenous factors**. An inevitable question one would have to ask is: how do we separate the effects of the CU implementation from the effects of economic recovery in the wake of the global financial crisis? For instance, regression analysis undertaken by the EBRD shows that “changes in volumes of imports between 2009 and 2010 were largely driven by trade recovery effects”.<sup>37</sup> We therefore take into account the effect of global conjuncture on the change in intra-bloc trade volumes in 2010, alongside possible CU-induced trade creation effects.

For these reasons, we will limit our analysis to the period 2010-2012, with a breakdown by quarters to allow for the factors influencing trade flows (seasonality of demand, global trends, etc). The analysis of trade flows will focus on two sectors that appear particularly affected by the introduction of the Customs Union as they have substantial export volumes both within and outside the integration grouping: ferrous metals, and machinery and equipment.

### 3.3.2.1 Trade creation effects

A sectoral analysis of the trade flows dynamics shows a very modest increase in intra-Union trade within two years of the Customs Union operation. For instance, Russia’s exports of ferrous metals, which constitute its most important export product group after oil and gas,

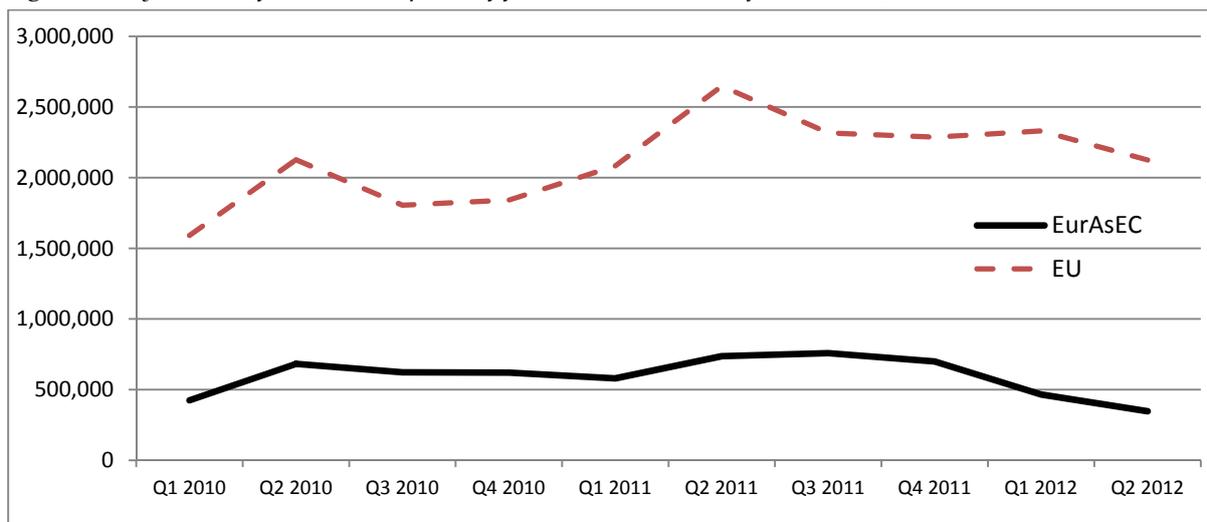
<sup>35</sup> Volumes of mutual trade in 2010-2011, Eurasian Economic Commission ([http://www.tsouz.ru/db/stat/iCU201112new/Documents/IALL201112\\_2.pdf](http://www.tsouz.ru/db/stat/iCU201112new/Documents/IALL201112_2.pdf)).

<sup>36</sup> Volumes of mutual trade in 2010-2011, Eurasian Economic Commission ([http://www.tsouz.ru/db/stat/iCU201208/Documents/IALL201208\\_2.pdf](http://www.tsouz.ru/db/stat/iCU201208/Documents/IALL201208_2.pdf)).

<sup>37</sup> EBRD (2012), p. 69.

demonstrate a very ambiguous trend (see Figure 5). After initial growth in the first two quarters of 2010 (which can be attributed to post-crisis recovery), Russia’s exports to the EurAsEC remained quite stable for a year. The export volumes did pick up substantially in 2011 (mainly due to the increase in demand for steel products on global markets, as a sharper export increase to the EU in the same period would suggest), only to decline in the first half of 2012, which might be an indication of seasonal factors in demand. This development leads us to assume that Russia’s export of ferrous metals could have been initially encouraged by the improvement of trade conditions within the CU, yet failed to have a sustainable effect, with Russia’s exports to its member countries returning to the pre-2010 levels in mid-2012.

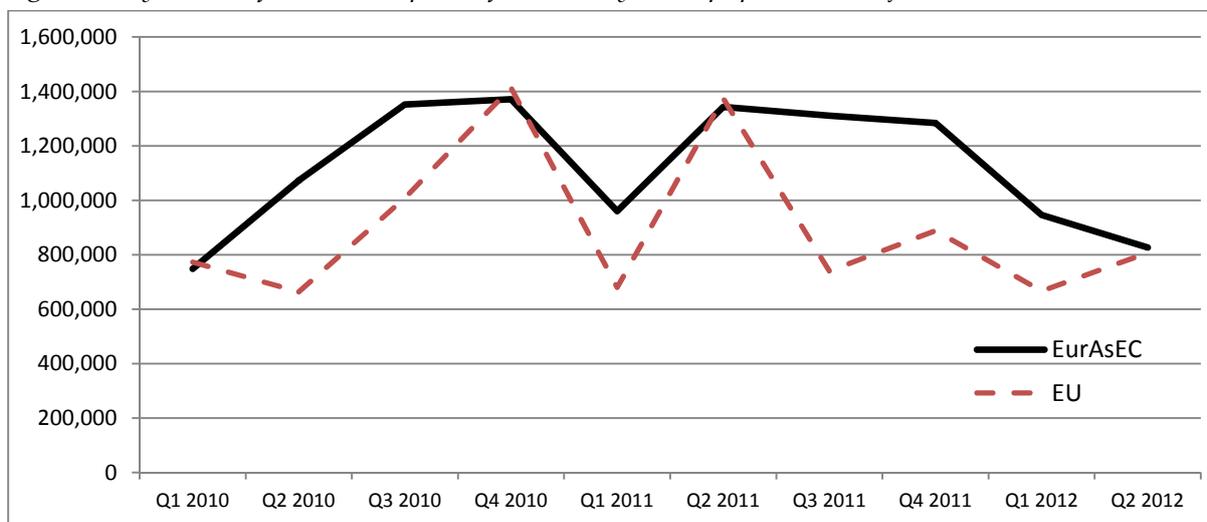
Figure 5. Dynamics of Russia’s exports of ferrous metals to major markets, thousand \$US



Sources: Russia’s Federal Customs Service data; authors’ graphics.

A similar trend is observed in Russia’s export of finished goods. As Figure 6 illustrates, the first three quarters of 2010 saw a two-fold increase in Russia’s exports of machinery and equipment, largely due to the post-crisis recovery of demand. However, in the last two years Russian exports of these products have fluctuated and ultimately declined to the (roughly) pre-Customs Union level.

Figure 6. Dynamics of Russia’s exports of machinery and equipment to major markets, thousand \$US



Sources: Russia’s Federal Customs Service data; authors’ graphics.

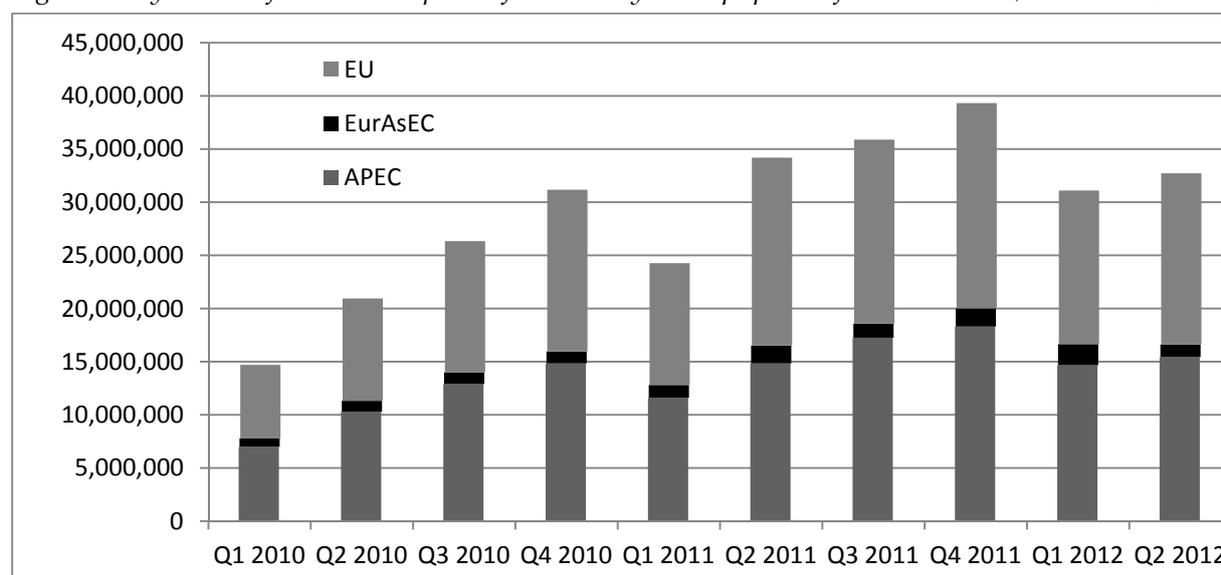
As the data above show, changes in export volumes to EurAsEC markets were mostly consistent with fluctuation in exports to the EU, apart from the stable volumes of exports at the end of 2011, while supplies to the EU saw a sharp decrease. This latter 'divergence' might indeed suggest the improvement of Russian suppliers' trade terms in the EurAsEC due to the Customs Union. However, this support seems to have been rather short-lived, as Russia's exports of machinery and equipment to EurAsEC countries returned to the same level as exports to the EU in mid-2012, despite prior elimination of tariff barriers with Belarus and Kazakhstan within the Customs Union.

Overall, these volatile dynamics in major export-oriented sectors of Russia's economy fail to supply strong evidence for the sustainable trade-creation effects of the introduction of the Customs Union. This development is rather different from the strong trade creation effects in these industries seen in the early stages of European integration. On the one hand, the increase in 2011 could indeed have been aided by the elimination of trade barriers. On the other hand, initial trade creation effects appear rather precarious in the short run, illustrated by the slump in 2012. We therefore conclude that integration steps beyond tariff policy are needed to boost intra-bloc trade in the key sectors.

### 3.3.2.2 Trade diversion effects

The dynamics of imports to member states help to estimate possible trade diversion effects in the Customs Union. In order to ascertain how the share of imports of manufactured products from EurAsEC countries changed in comparison to imports from major suppliers (the EU and APEC countries), we analyse the change in Russia's<sup>38</sup> import structures for the period under review. Interestingly, the EurAsEC share of machinery and equipment imports to Russia increased at the beginning of 2011 (Figure 7), while imports from other suppliers shrank. However, the share of EurAsEC did not exceed 6% in mid-2012 (see Table 6), thus remaining a rather minor line in Russia's imports.

Figure 7. Dynamics of Russia's imports of machinery and equipment from EurAsEC, thousand \$US



Sources: Russia's Federal Customs Service data; authors' graphics.

<sup>38</sup> As the biggest market in the bloc.

Table 6. Share of Russia's imports of machinery from EurAsEC in comparison to major suppliers

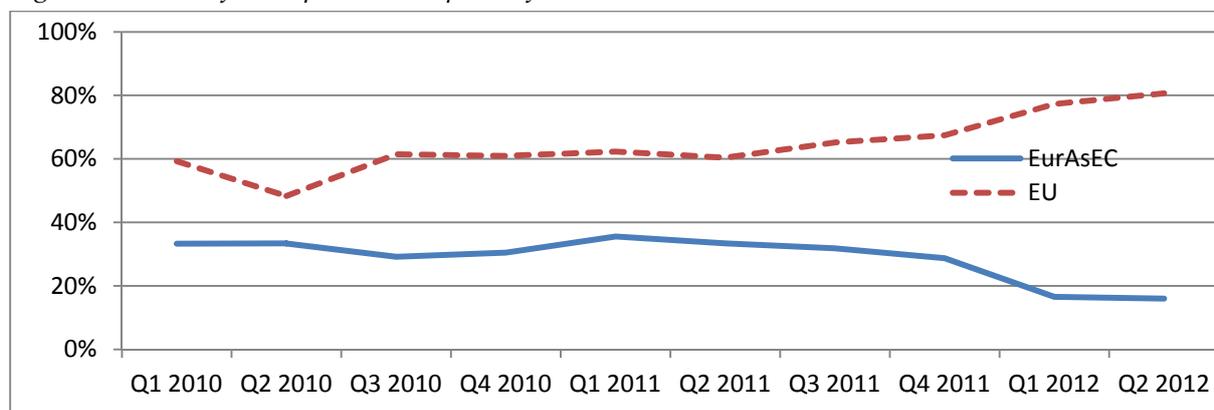
	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012
APEC	43%	45%	45%	44%	43%	39%	43%	43%	43%	43%
EurAsEC	4.8%	4.5%	3.9%	3.3%	4.5%	4.5%	3.4%	4.0%	5.8%	3.3%
EU	43%	42%	43%	45%	43%	47%	44%	45%	42%	45%

Sources: Russia's Federal Customs Service data; authors' graphics.

As Table 6 illustrates, APEC and EU suppliers managed to preserve their share of imports to Russia, despite the more discriminatory terms of the newly created Customs Union.

In contrast to the early EEC developments (spurred mainly by the onset of the Common Agriculture Policy), the introduction of the Customs Union and the Common Economic Space appears not to have caused trade-diverting effects in the most important food sectors of the member states. For instance, the share of Russian imports of meat products from the EU not only remained stable in 2011, it also managed to increase substantially in the first quarters of 2012 (see Figure 8 below), while the share of EurAsEC suppliers decreased.

Figure 8. Shares of meat products imported from EurAsEC countries and the EU, 2010-2012



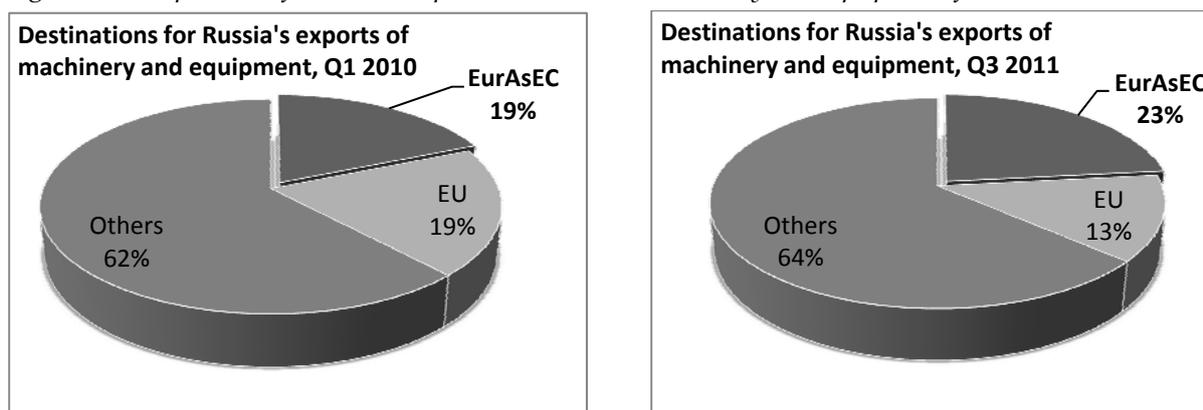
Sources: Russia's Federal Customs Service data; authors' graphics.

Thus, in line with EEC experience, the trade diversion effects in the sector of machinery and equipment have not been prominent in the CU so far, which can be attributed to rather uncompetitive domestic producers. However, unlike the European experience of building an agricultural 'fortress', food imports (in particular, meat products) from external suppliers were not replaced by intra-Union producers. This trend might be attributed to the poor competitiveness of its agricultural producers and comparatively minor changes to industry regulations brought about by the Customs Union.

### 3.3.2.3 Effects on the trade structures of member states

Finally, a word on the impact of the customs union on the foreign trade structures of the member states is warranted. In Section 1, we stated that one of the possible economic motivations for Russia to embark on the Eurasian integration project was the potential to increase the exports of manufactured products and thus help diversify its economy away from raw material export dependency (mostly oil and gas). On the one hand, the share of Russia's intra-regional exports increased in the wake of the creation of the Customs Union (see Figure 9, below).

Figure 9. Comparison of Russia's export structure in machinery and equipment from 2010 to 2011



However, Russia's export structure in machinery and equipment has not managed to sustain these gains in the longer run: Russia's share of manufactured goods exported to EurAsEC rebounded to 16% in mid-2012 (see Figure 10). Despite more favourable conditions introduced by the Customs Union, its export share to EurAsEC markets has in fact decreased over the past two years (compared to early 2010).

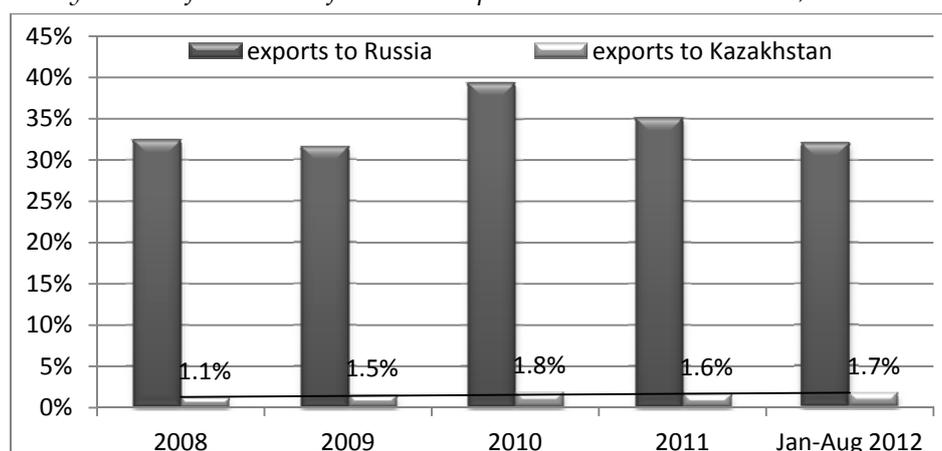
Figure 10. Structure of Russia's exports of machinery and equipment in mid-2012



Sources: Russia's Federal Customs Service data; authors' graphics.

Furthermore, the share of Belarus' total exports to CU members has been declining for 2.5 years since the CU was established: not only did Belarus fail to increase its modest share of trade with Kazakhstan; it also saw a dramatic decrease in its total export share to Russia, its main trade partner (see Figure 11 below). Contrary to what one would expect from CU implementation, its share of exports to Russia decreased by 8% by mid-2012.

Figure 11. The dynamics of the share of Belarus' exports to other CU members, 2008-2012



Source: Belstat (National Statistical Committee of Belarus), 2012.

Despite treating the year 2010 as a 'post-crisis anomaly', this counter-intuitive trend of Belarus' falling share of exports in manufacturing to Russia during 2011-2012 raises further questions about the potential of export increase for Belarusian producers in the Customs Union. It therefore casts doubt on the improvement of Belarus' terms of trade in manufactured products following the launch of the Common Economic Space.

To sum up, the EurAsEC Customs Union appears to have had a two-pronged impact on the structure of its member states' foreign trade in crucial sectors (ferrous metals, machinery and equipment). On the one hand, Russia (like more export-oriented countries in terms of manufactured goods) did indeed increase its intra-Union trade in 2011, amid the CU implementation. On the other hand, the dwindling share of CU-bound exports from Belarus, as well as Russia's 'rebound' in 2012, lead us to believe that the short-term effects of the introduction of the Customs Union are over, and that its member states will need to introduce new policy measures to sustain intra-bloc trade growth.

#### 4. Conclusions and recommendations

The major challenges facing the Eurasian Economic Union are:

1. Eliminating non-tariff barriers in intra-bloc trade, especially those stemming from customs clearance procedures, transport infrastructure (due to large distances between economic centres) and business regulation (due to differing regimes in Russia, Belarus and Kazakhstan). The underlying question that remains is: will these goals be achieved by attributing more competences for the Commission and the Court or by using the national mechanisms in the member states? On the one hand, the establishment of “competing jurisdictions” for businesses, highlighted by the representatives of the Eurasian Economic Commission, is supposed to facilitate intra-bloc trade and investments. On the other hand, this regulatory competition will have to be paralleled by the alleged “coordination” of a number of policies in a very limited period of time (by 2015).
2. Harmonising its tariff and non-tariff regulations with Russia’s WTO commitments, and possibly commitments arising from Kazakhstan’s anticipated accession. These external commitments are accounted for by the Eurasian Economic Commission through the regular process of tariff revision; however, the changes to crucial non-tariff barriers (such as the introduction of the automobile recycling fee, criticised by the European Commission) need to be reversed.<sup>39</sup>
3. Agreeing on the negotiation framework for external relations. According to CU officials,<sup>40</sup> the Eurasian Economic Commission now holds a mandate on negotiating trade agreements with the EU on behalf of its member states, most importantly, Russia. At the moment, this move is resisted by the European Commission, which is of the opinion that the conditions for an EU-CU agreement are not in place, due to the fact that the Eurasian Customs Union is not WTO-consistent.<sup>41</sup> Obstacles to the CU’s full compatibility with WTO criteria need to be urgently and properly addressed if the CU intends to be recognised as a negotiating party by its major trading partners.

The Eurasian Economic Commission and member states can mitigate these challenges in a number of ways, in particular by:

- 1) Tracking down the progress of eliminating trade restrictions within the Customs Union and making the monitoring conclusions available to the WTO members (*the Commission Board*);
- 2) Announcing the likely rates of import tariffs after the implementation of Russia’s WTO commitments and Kazakhstan’s adoption of the Customs Union’s CET; explicitly outlining and communicating the timeline of WTO-agreed changes in non-tariff barriers (*Customs Tariff and Non-Tariff Regulation Department*);
- 3) Explaining the main provisions of the future Treaty on Eurasian Economic Union pertaining to external trade and communicating it to the WTO partners (*Integration Development Department*).

<sup>39</sup> See the speech by Karel De Gucht, European Commissioner for Trade, “After WTO Accession: Reform and EU-Russia Trade Relations”, ALDE Seminar of the Alliance of Liberals and Democrats for Europe, Brussels, 5 December 2012.

<sup>40</sup> Tatyana Valovaya, at the CEPS event on 3 December 2012.

<sup>41</sup> Peter Balas, at the same event.

Having adopted the framework of Haas & Schmitter (1964), we evaluated the main indicators of the envisaged economic union at different stages based on the scale of 'low' to 'high'. Comparative estimates of the viability of economic union formation are aggregated in the table below.

Table 7. Conditions underpinning successful implementation of economic unions (Haas & Schmitter)

Conditions	Indicators to operationalise	Measurement Scale	EEC	CU
Background conditions (EEC: 1957, CU – prior to 2010)				
1. Size of units	Population of member states, GDP volumes	Homogeneity: low to high	Medium: 3 big + 3 small MS	Medium: 1 big +2 small MS
2. Distance among economic centres	Minimum road distance between major trading cities	Long distance low potential and vice versa	Medium	Low
3. Initial Rate of Transactions	reliance on intra-union trade: share of regional exports in overall foreign trade	< 10%: low 10-50%: medium > 50%: high	Medium to High	Medium <sup>42</sup> , but lower than EEC
Formation Conditions				
4. Implementation of Common Trade Policies <sup>43</sup>	-eliminating intra-bloc duties -implementing common customs policy	Implemented: high; Lacking: low	High (completed in 1968)	Medium: - tensions over oil export duty - lingering CET exemptions
5. Powers of the Union	Impact of the supranational bodies: 1) competence of the Commission; 2) direct application of Court decisions	If the bodies can change outcomes in major policy areas: high, if not: low	High	Low: - weak role in infringement procedure - Court rulings to be applied
Process Conditions (EEC: 1957-1968, CU: 2010-2012)				
6. Decision-Making procedure	Prevailing governance mode applied in the union	Intergovernmental – low; Supranational – high	High Mixed with strong supra-national bodies	Medium Mixed with strong inter-governmental features
7. Outcome-based Transactions	Interdependence: trade dynamics and structure changes	Grows -high; does not change -low	High	Medium -growth in2011 -stagnates 2012
Level of Economic Integration	High or Low		High	Medium
Level of Institutional Integration	High or Low		High	Low

<sup>42</sup> In part, due to the already existing free trade area within the CIS (but FTA had existed prior to the EEC as well: e.g. Benelux).

<sup>43</sup> We have changed this indicator from 'governmental purposes' in Haas & Schmitter to account for the more significant role of government leaders in the Eurasian context.

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- Multidisciplinary, multinational & multicultural research team of knowledgeable analysts,
- Participation in several research networks, comprising other highly reputable research institutes from throughout Europe, to complement and consolidate CEPS' research expertise and to extend its outreach,
- An extensive membership base of some 132 Corporate Members and 118 Institutional Members, which provide expertise and practical experience and act as a sounding board for the feasibility of CEPS policy proposals.

## Programme Structure

### **In-house Research Programmes**

Economic and Social Welfare Policies  
Financial Institutions and Markets  
Energy and Climate Change  
EU Foreign, Security and Neighbourhood Policy  
Justice and Home Affairs  
Politics and Institutions  
Regulatory Affairs  
Agricultural and Rural Policy

### **Independent Research Institutes managed by CEPS**

European Capital Markets Institute (ECMI)  
European Credit Research Institute (ECRI)

### **Research Networks organised by CEPS**

European Climate Platform (ECP)  
European Network for Better Regulation (ENBR)  
European Network of Economic Policy  
Research Institutes (ENEPRI)  
European Policy Institutes Network (EPIN)